No. 150.

Brf. of Newman, Northrup, Levinson & Becker for Respondents

Office Supreme Court U.S.
FILED
JAN 21 1901
JAMES H. MCKENNEY,
Clerk.

Filed Jan. 21, 1901.

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OCTOBER TERM, A. D. 1900.

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UNITED STATES RUBBER COMPANY, et al.
PETITIONERS.

vs.

AMERICAN OAK LEATHER COMPANY et al.,
RESPONDENTS.

Certiorari to Circuit Court of Appeals for Seventh Circuit

Brief and Argument for The American Oak Leather Company et al., Respondents.

JACOB NEWMAN,
GEORGE W. NORTHRUP,
S. O. LEVINSON and
BENJ. V. BECKER,
For Respondents.

Geo. Hornstein Co., Printers, Chicago.

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Brief and Argument for The American Oak Leather Company et al., Respondents.

Respondents, as creditors of the Fargo Company, filed their bill in the United States Circuit Court on September 11, 1896, charging the Petitioners, among other things, with having obtained possession and control of all the property of the Fargo Company by grossly fraudulent means, and praying that they be decreed to deliver the same to a receiver for the benefit of Respondents and the other *bona fide* creditors of the Company. The court appointed a receiver, who took, and now holds possession of said property, amounting to about $115,000. On the final hearing the Circuit Court decreed, that the Petitioners were guilty of *constructive fraud*, set aside their preferences, and directed the fund in the hands of the receiver to be distributed *pro rata* among

all the creditors of the Fargo Company, including both Petitioners and Respondents. (Rec., 639.)

Petitioners appealed from this decree to the Circuit Court of Appeals, on the ground that they had *not been guilty of any fraud whatever*, and were entitled to keep and hold all their preferences. The Respondents took their cross appeal from this decree to the same court, on the ground that Petitioners had been *guilty of actual fraud*, and were, therefore, not entitled to share in the funds in the hands of the receiver. The Court of Appeals found Petitioners *guilty of actual fraud*, and excluded them from sharing in said fund.

The United States Rubber Company and its co-petitioners filed their petition in this court for a writ of *certiorari* to the October term, 1899; the writ was granted, and this cause comes to this court by means of said writ.

Respondents are satisfied with the action of the Court of Appeals, and therefore, have no error to assign, or cause to complain. The opinion of that court will be found at large on page 717 of the record in this cause. Two federal judges (Grosscup and Mr. Justice Brown of this court) found Petitioners guilty of *constructive fraud*; the Circuit Court of Appeals (Woods and Jenkins), found the Petitioners guilty of *actual fraud*, but Mr. Justice Brown dissented, on the ground that in his judgment, Petitioners had been guilty of only *constructive fraud*.

Respondents contend that Petitioners were guilty of actual fraud, while Petitioners insist that they were guilty of neither *constructive*, nor *actual fraud*. Such are the questions presented by this record.

Master's Report.

The Circuit Court approved the Master's report, finding the Petitioners guilty of *constructive fraud*. Opposing counsel in their brief (p. 14), insist that the Master's report must be taken as "presumptively correct." Under the facts in this record, we challenge the correctness of this contention, because there is substantially no conflict in the evidence, and the Master was not called on to reconcile conflicting testimony. In short, the Master's report is nothing but a *condensed statement of so much of the undisputed testimony as he deemed to be material to his view of the case.*

In this brief, page 92, we show why the Master's report is not to be taken, even in the first instance, as "presumptively correct," and why the court ought to consider the facts in the record *de novo.*

The concrete matters of fact, the acts and doings of the Petitioners themselves and their respective agents, as found by the Master in his report, demonstrate that an *actual fraud*, and not merely a *constructive fraud*, had been perpetrated by the Petitioners upon the Respondents as creditors of the Fargo Company.

The Master has drawn his own inferences from the facts as found by him, and in so doing has wholly ignored the conclusions which the law declares must follow as a logical and inevitable result from the facts themselves. The cases in which this law is stated are discussed at length in this brief. The conclusion of good faith found by the Master is in conflict with his findings as to the concrete facts, and must, therefore, yield to the facts themselves, which conclusively establish bad faith in the Petitioners.

We earnestly contend that the Master in his report has

erroneously stated many, and wholly ignored more, of the controlling facts, and has incorporated in his report *only such facts as he deemed consistent with his theory of the case.* Most of the evidence comes from the lips of the men charged with the fraud itself, and that circumstance is of vital importance when the fraud is disclosed by a long series of complex and involved transactions.

The fraudulent scheme planned and consummated by the Petitioners under which they hoped to pay themselves out of the assets of the Fargo Company and to exclude the Respondents from sharing therein, had its inception in January, 1896. The machinery was then put together by which the assets of the Fargo Company, six months later, were seized by the Rubber Companies and the Bank for the purpose of consummating that scheme.

In order to show the court wherein the Master erred as to the facts found, as well as to the facts ignored by him in his report, it is necessary for us to present a full and detailed statement of the material facts, wrung with difficulty from the Petitioners themselves. These facts and the surrounding circumstances will be presented in their historical order.

Statement.

For many years prior to 1889, C. H. Fargo & Co. was a firm engaged in the business of manufacturing and selling, at wholesale, boots and shoes throughout the Northwest, with its principal place of business at Chicago. In December of that year the firm was incorporated under the laws of Illinois, with a capital stock of $400,000; the corporation assumed the firm name (C. H. Fargo & Co.) and succeeded to the firm's business and carried on the same substantially as if no change had taken place.

In 1892 C. H. Fargo, the founder of the house, died and left the business to his three sons, Charles E., Frank M. and Edward A. Fargo, who controlled and directed the corporation (C. H. Fargo & Co.), and its affairs until the Rubber Companies got control in January, 1896.

The house of C. H. Fargo & Co. had been dealing with the Rubber Companies for nearly a quarter of a century (Rec., 217); their relations had been and were close and intimate, and their business transactions during the greater part of that period reached the enormous figure of $500,000 annually. (Rec., 496.) Charles L. Johnson, the confidential representative of the Rubber Companies, was the close personal friend of Charles E. Fargo, the president of the Fargo Company.

While these relations existed the panic of 1893 occurred. At that time the Fargo Company owed the Rubber Companies $250,000 (Rec., 219) for merchandise, and had in its possession more than $100,000 worth of rubber goods on sale, which had been shipped on consignment by the Rubber Companies; making a total obligation of over $350,000, during that period of commercial distress and disaster.

The Fargo Company likewise owed the Metropolitan National Bank (one of the Petitioners) about $130,000. At the height of the panic of 1893 the Bank became nervous and demanded security in the form of judgment notes; the Fargos then, as they did later in January, 1896, immediately sent for their friend Charles L. Johnson, and laid before him the Bank's demands. Johnson came to Chicago, and after going over the situation, stated that he saw no necessity or occasion for giving judgment notes, and thought it unnecessary and unwise; but the Bank was obstinate and would not be denied. Johnson then said

that if the Bank insisted upon being secured by judgment notes, he felt it to be his duty to take like security for the Rubber Companies, so as to be on an equality with the Bank, but asked nothing more (Rec., 219, 222.) Judgment notes were then given to the Bank and the Rubber Companies, which were, some time in the year 1895, surrendered and plain promissory notes taken for the unpaid balances.

The United States Rubber Company was organized with a capital of $50,000,000 (Rec., 235) in the early part of 1895, and in April of the same year, it obtained control of L. Candee & Co., (one of the Petitioners), and of all the Candee Co's. assets; and thereafter the Candee Co. was merged in and passed under the control of the United States Rubber Company. At this time (April, '95) the Fargo Company owed the Candee Co. upon open account, about $44,900, which it was then unable to pay; this over-due account was closed with the Fargo Company's plain notes, which remained outstanding in January, 1896, when the scheme of which we complain was planned by the Petitioners.

In January, 1896, when this fraudulent scheme was set in motion, the Fargo Company owed the United States Rubber Company (Rec., 289) over $140,000, then past due, and owed the Candee Company $44,900, represented by the plain notes given to close up the old account, past due in April, 1895, which the Fargo Company was then unable to pay, and had also in its possession and mingled with its other stock over $100,000 worth of consigned rubber goods.

THE FARGO COMPANY'S LIABILITIES IN JANUARY, 1896, $436,653.33 AND ITS ASSETS $120,512.44.

The Master finds (Rec., 163) that the liabilities of the Fargo Company were on January 2, 1896, as follows:

United States Rubber Company	$141,537.13
L. Candee & Co. (overdue April, 1895 account)	44,900.00
Metropolitan National Bank	40,000.00
Other creditors	210,216.20
Total	$436,653.33

The actual value of the assets is not disclosed by the record with precise accuracy, but sufficient is shown to enable the court to arrive at substantially correct conclusions.

Assets of the Fargo Company on January 2, 1896.

Stock in Chicago	$ 65,000.00
Stock, fixtures, machinery, etc., at Dixon	12,500.00
Outstanding accounts, etc (Rec. 298, 299)	43,012.44
Total	$120,512.44

The real estate and manufacturing plant at Dixon, Illinois, which was conveyed to the Metropolitan National Bank in August, 1896, was by that institution abandoned as not worth the liens thereon which had ripened into decree and sale. The Petitioners having placed no value upon the Dixon property we therefore do not include the same in the assets.

The foregoing statement of assets shows what the tangible property brought, in September, 1896, at a fair sale, as set out in the answers of the Rubber Companies and the Bank

Rec., 50–60, 117), and established by the testimony of the witnesses. Charles E. Fargo states (and he is uncontradicted) that there was no material change in the amount of the assets or liabilities of the Fargo Company from January to August, 1896. (Rec., 270.) The outstanding accounts and bills receivable were collected by the Rubber Companies and realized a total of $43,012,44 as the result of the most diligent efforts to collect and convert them into money. (Rec., 298, 299.) Mr. Porter, one of the Rubber Companies' counsel, testifies that the total accounts on the books were $128,499. Of this amount only $69,500 were live accounts, and the remainder were old, stale and uncollectible. (Rec., 300.)

We thus find that the true condition of the Fargo Company in January, 1896, when the fraudulent scheme was inaugurated, was substantially as follows:

Liabilities	$436,653.00
Assets	120,512.44
Shortage	$316,140.56

At this very time the Fargo Company was vigorously pressed for payment by its other creditors, whose demands it could not satisfy. (Rec., 200.)

The foregoing facts show that the Fargo Company was hopelessly and irretrievably insolvent on January 2, 1896, at the time the scheme we attack had its origin.

In the throes of bankruptcy from which no business man could honestly expect to escape, the Fargos telegraphed for their friend Charles L. Johnson, who was likewise the confidential representative of the Rubber Companies, and in response to this message Johnson came to Chicago and brought with him Houston M. Sadler, Jr. They reached Chicago on January 2, 1896, and on the evening of that day

commenced, with Charles E. Fargo, negotiations which on the 6th terminated in the agreement, the character of which is now assailed by the Respondents.

THE MOTIVES WHICH ACTUATED THE RUBBER COMPANIES IN MAKING THE SECRET AGREEMENT BY WHICH THEY GOT AND MAINTAINED SECRET CONTROL OF THE FARGO COMPANY.

When Johnson and Sadler reached Chicago, January 2, 1896, in answer to Fargo's urgent telegram, the Rubber Companies had at stake and in danger of losing the same, $284,900, as follows:

Due Candee Co. on claim past due April, 1895 (Rec., 513, 514)	$ 44,900
Due United States Rubber Company on claim past due when Johnson reached Chicago (Rec., 289)	140,000
Due on consignments for rubber goods previously consigned to, and then in the possession of the Fargo Company (Rec., 187)	100,000
Total	$284,900

By reason of the course of dealing between the Fargo Company and the Rubber Companies with respect to these consigned goods, the Fargos and their solicitor, Mr. Thomas Cratty, insisted at the Auditorium interview, January 2, that the consigned goods were at that time the property of the Fargo Company, at least as between its other creditors and the Rubber Companies, and were subject to attachment at the suit of such other creditors. (Rec., 340, 341, 342.)

The precarious status of these consigned goods was announced to Johnson by Mr. Cratty during the progress of the negotiations, and substantially acquiesced in by the parties (Rec., 340–343):

"I think," says Mr. Cratty, in answer to a question put

by Mr. Beale (Rec., 344), "the conclusion we arrived "at was that the *goods were in a dangerous condi-* "*tion in January if other creditors should attach* and the "Rubber Companies should undertake to claim them but "after that time I really believed they were perfectly safe."

By "after that time" Mr. Cratty referred to the period after the inauguration of the January scheme.

Thus it appears that when Johnson and Sadler reached Chicago they represented an unsecured claim of $44,900, nearly a year old; a second unsecured claim of $140,000, all past due; and a third unsecured claim for consigned goods, aggregating over $100,000, the title to which they found in imminent danger. This makes a total of $284,900, due the Rubber Companies when the January interview took place at the Auditorium Hotel, the greater part of which would be lost, if not immediately and absolutely secured.

The Fargos likewise had absolutely nothing to lose and everything to gain by prolonging the existence of the Fargo Company. Apparently the Fargo brothers were possessed of a considerable personal fortune in addition to their interest in the corporation (Rec., 327.) They were personally liable in January, 1896, as indorsers upon the Fargo Company's commercial paper, and were eager for any scheme which promised to prolong the company's existence so that they might get rid of this personal liability as indorsers before the final collapse. In the plan adopted they saw a possibility of securing this result. (Rec., 214. In fact, they were eminently successful, for all the outstanding paper on which they were indorsers, was paid off and taken up before August, 1896, when the final collapse came, and the Fargos guaranteed no paper for their com-

pany after the January scheme was set in motion. (Rec., 214–215.)

We now reach that stage in the history of the Fargo Company during which was launched the secret scheme by which the Rubber Companies undertook to control the Fargo Company, appropriate all its assets, and exclude its other creditors from all share therein.

JOHNSON AND SADLER REACHED CHICAGO JANUARY 2, 1896, IN ANSWER TO FARGO'S TELEGRAM AND HAD THEIR FIRST INTERVIEW WITH THEIR COUNSEL, MR. BEALE, AND CHARLES E. FARGO, PRESIDENT OF THE FARGO COMPANY, ON THAT DAY.

At the first interview, on January 2, 1896, the Fargos told Johnson that the Fargo Company was in pressing need of $25,000—raised afterwards to $50,000—to keep the concern afloat; that the company would have to "go to the "wall at once" if it did not then get the money. (Rec., 200, 202.) Although the relations between the Fargos and the Rubber Companies had been intimate for years, and their dealings had reached millions, Johnson at first refused to advance a single dollar. On the contrary, without any investigation or inquiry, he demanded that the Fargo Company should at once prefer the Rubber Companies, to the exclusion of all other creditors. (Rec., 201.) *Fargo refused, saying that if the Rubber Companies gave him no assistance, the Fargo Company would treat all of its creditors on an equality, and he knew of no reason why the Rubber Companies should be preferred.* (Rec., 511, 552.)

On these subjects Johnson testified as follows:

"Q. (Rec., 512.) When the subject of chattel mort-"gages was discussed, who was present? A. Mr. Beale, "certainly, Mr. Charles Fargo, certainly; I am inclined to "think Mr. Sadler and Mr. Cratty.

"Q. Had you made up your mind to make the advance "before the Fargos had refused to secure your people? A. "I had not.

"Q. (Rec., 511.) Did you not, when you first came to "Chicago, or during your stay in January, 1896, insist or "request the Fargos to secure the old indebtedness to the "companies you represented, without advancing any addi- "tional moneys, and did not Charles Fargo say that he "*would not do that, but would treat all the creditors alike?* "A. To that effect, yes.

"Q. Did he also say that he preferred treating all the "creditors on an equality? A. Words to that effect."

On this point Mr. Beale testified as follows (Rec., 552):

"In the discussion (from January 2 to 6, 1896), Mr. John- "son had said to Mr. Fargo, one day in my hearing, that if "they were unable to get the advance, *and they had to go* "*to the wall*, he thought, in view of past treatment, the "Rubber Companies ought to be preferred by the Fargo "Company; but this observation was not met with any "particular favor by Mr. Fargo, who said if they could "not get further assistance and had to fail, they proposed "to treat all the creditors alike."

Under these circumstances, the Rubber Companies would have been compelled to share *pro-rata* on their claims, aggregating $284,900, with the other creditors, had they not, by advancing the $50,000, purchased the absolute control of the assets and corporate powers of the Fargo Company, and thereby put themselves in a position to appropriate all its property and assets to their own use, at their pleasure, *but always at the sole risk of other creditors who might, in the meantime, give the Fargo Company credit.*

The Rubber Companies concluded to purchase control, as the only thing left them, and as a result of that determination there was evolved the scheme of control, which for brevity, we call the January Scheme.

JOHNSON AND SADLER UNDERSTOOD THAT THE FINANCIAL CONDITION OF THE FARGO COMPANY WAS HOPELESS.

The Rubber Companies claim that the Fargos stated the amount of their assets and liabilities while the January negotiations were in progress. On this subject Mr. Beale testifies: "I do remember, in a general way, that Mr. "Fargo asserted that his assets were largely in excess of "his liabilities." (Rec., 550.) Johnson says: "A brief "examination of some figures they presented indicated "to us that the business was fully solvent." (Rec., 497.)

Fargo says he "Produced figures showing the "assets and liabilities of the corporation." (Rec., 226.) Counsel finally got Fargo to say that he told Johnson that his liabilities were $378,000, and assets $550,000, viz.: Factory at Dixon, $175,000 (abandoned by the Bank as worthless); merchandise, $150,000; and accounts, $225,000. (Rec., 262–264.) But during these January negotiations, which lasted nearly a week, Johnson and Sadler, two shrewd business men, familiar with large affairs, did not even visit the Fargos' place of business (only a few blocks away); made no examination of the Company's books or assets; asked for no inventory; made no inquiry into the character of the outstanding accounts. (Rec., 519.) Johnson, after a rigid cross-examination, gives as the sole reason why he and Sadler made no investigation that they did not have sufficient time to do so, although they were in Chicago nearly one week, solely on this business, and with nothing else to do. One hour spent on the ledger of the Fargo Company would have shown Johnson that the accounts did not exceed $130,000 at their face, and that 50 per cent. of these accounts were old, stale and uncollectible. The Rubber Companies' claims (including consigned goods) amounted

to about $284,900, and only deliberate and willful blindness could have induced Johnson and Sadler to estimate the company's assets at over one-half that sum.

But it is manifest from the evidence as a whole that Johnson and Sadler clearly recognized the critical condition of the company and its practically hopeless bankruptcy.

Compare their conduct in 1896 with their attitude in 1893, when they believed the concern solvent. During the panic of 1893, when the Bank demanded security, Mr. Johnson was sent for, as we have stated (p. 5), and came to Chicago as the friend of the Fargos. In that distressing period of the commercial history of this country, Johnson saw nothing in the condition of the Fargo Company that demanded any drastic measures, and insisted that the demands of the Metropolitan National Bank were unreasonable, and did his level best to induce the bank to recede from its position; he accepted judgment notes for the Rubber Companies only when the Bank insisted upon that kind of security, in order to be placed on a level with the Bank itself.

If other evidence on this point were lacking, the peremptory telegram sent by Johnson to Beale on January 7 would sufficiently show his anxiety of mind and keen realization of the precarious condition of affairs.

Mr. Beale, counsel for the Rubber Companies, himself testifies that although the judgment notes had been actually delivered before Johnson left Chicago, about January 6th, the other details of the January arrangement had not been completed, nor had the change in the directorate been accomplished; that this delay was due to insistence on the part of Fargo that the various conditions upon which the Rubber Companies should have the right to enter up

judgment and close up the company should be definitely specified in a written agreement. Mr. Beale further says:

"I finally became very much provoked at Mr. Fargo's "captious attitude. He and Mr. Cratty assented to the "written agreement as finally drafted, and then they "wanted a provision put into the note, substantially as "would be put into a note secured by a trust deed, to the "effect that the notes were subject to the agreement. * "* * I flatly refused to consent to it, as being likely to "lead to a lot of trouble in the future. * * * I told "him that I thought for a man whose concern was em- "barrassed, and who stated it must go to the wall if it did "not get some temporary help to pull it through its "temporary embarrassments, he was displaying a "good deal of captiousness. * * * I showed him "a telegram which I had received on the 7th of January, "from Johnson, reading as follows: '*Sadler has ex-* "*plained the situation to me. Think position should* "*be made absolute as soon as possible, by completing agree-* "*ment as arranged, and organization of board of directors* "*to prevent giving other judgment notes.* * * * *Fail-* "*ure to thus protect us, should result in executions by us.* "*Use, at your discretion, all judgment notes in your posses-* "*sion, in order to put our claim beyond peradventure.*'" (Rec., 554.)

This telegram being exhibited to Fargo, he yielded, and placed the control of the Fargo Company and all its property, in the hands of Johnson (Rec., 555), to be exercised by him in the interest of the Rubber Companies *at his sole discretion*, although at that time the Rubber Companies had advanced only $10,000. (Rec., 556.)

Johnson & Beale would not permit the new directors of the Fargo Company to vote the judgment notes, but insisted upon this authority being given by the old board; this conclusion was reached after an examination of the Illinois authorities on the subject of insolvent corporations. (Rec., 444.)

On this subject, Gilbert E. Porter, one of the Rubber Companies' counsel says (Rec., 446):

"The reason which actuated Mr. Beale and me to have "the judgment notes made by the old board instead of the "new and have them delivered prior to the change in the "Board of Directors was that we considered it better to do "so, because of the application of the rule *that a director "of an insolvent corporation* is not allowed to secure any "benefit to some one whom he represents. We looked up "several cases, among them that of *Blair* v. *Illinois Steel "Company.*"

Mr. Beale (Rec., 447) speaks to the same effect:

"I concluded it would be safer for the old board to act "to avoid any question which might be made in the fu-"ture."

These cumulative precautions, this exhaustion of every possible safeguard that the ingenuity of able counsel could devise, is a sufficient answer to the claim that the Rubber Companies had the slightest faith in the solvency of the Fargo Company, or in the personal honesty of the Fargos themselves.

THE CHIEF ELEMENTS OF THE JANUARY SCHEME BY WHICH THE RUBBER COMPANIES WERE TO SECURE ABSOLUTE AND SECRET CONTROL OF THE FARGO COMPANY.

After the threat of the Fargos to treat all their creditors on an equality, and their positive refusal to prefer the Rubber Companies unless the latter purchased such preference by advancing $50,000, Johnson and Sadler concluded to buy control of the assets and corporate powers of the Fargo Company, if, in its then financial distress, counsel could devise some method by which "absolute" security could be given, not only for the $50,000 to be advanced, but also for all their

pre-existing claims, absolute and contingent. Johnson demanded this absolute security over and over again. (Rec., 502, 511, 523.) Various plans for accomplishing this result were discussed. Simple judgment notes were first considered, and rejected, because the Fargo Company would be at liberty to give like judgment notes to other creditors. (Rec., 503.) Then the advisability of taking chattel mortgages as security was canvassed; but the parties concluded that the giving of a chattel mortgage would make it impossible for the Fargo Company to continue to buy goods on credit and borrow money—essential elements of the scheme—all parties understanding that any disclosures of that nature would destroy the credit of the Company. (Rec., 279, 513, 551, 567.)

Finally, the following new and novel scheme was settled upon, viz.:

1. The consigned goods should be separated by themselves on the sixth floor. (Rec., 340, 342.)

2. A special bank account should be opened for all sales of rubber goods received from the Rubber Companies on consignment, and special account books should be kept of such sales, (Rec., 426, 427).

3. Judgment notes payable *on demand* and aggregating $236,500 should be given to the Rubber Companies to secure not only pre-existing, but any possible future claims, direct and contingent.

4. The Candee notes for $44,900 should be paid as fast as they matured and they were all paid by April 27, 1896. (Rec., 531, 532.)

5. The Fargo Company, *when it had to suspend*, should assign all its accounts then existing and after acquired, to the Rubber Companies. (Rec., 205.)

6. The executive officers of the Fargo Company should be prohibited from giving any kind of security or preference to any other creditor.

7. The board of directors and secretary and treasurer of the Fargo Company should be placed in the absolute and secret control of the Rubber Companies (Rec., 552, 556).

8. The Fargos should be held out to the world as still owning and controling the corporation; and

9. Finally the whole scheme should be kept secret by all parties.

CONSUMMATION OF THE JANUARY SCHEME.

The resolution of January 6, in which the scheme is outlined, was drawn by the Rubber Companies' counsel. It is true, that none of the new directers had then been installed by the Rubber Companies, but the meeting of January 6th was held *for the express purpose, and was the first step in carrying out the scheme of control*, which had prior to this meeting been determined and agreed upon. (Rec., 61 to 63.) Eliminating its plausible recitals referring to the financial condition of the Fargo Company and its prospects, then in fact hopeless, this resolution provides:

1. That the Candee Company would lend its credit as an accommodation endorser to the Fargo Company to the extent of $50,000, by discounting the Fargo Company's plain notes, aggregating $51,500, and turning the proceeds over to that company;

2. That the Fargo Company would execute its three judgment notes to the two Rubber Companies, one for $45,000, payable to the Candee Company, to secure its contingent liability as endorser upon the plain notes given in settlement of the old account past due in April, 1895;

one for $51,500 to the Candee Company to secure its contingent liability on the plain notes aggregating $51,500, representing the new credit to be loaned by that company to the Fargo Company; and one for $140,000 to the United States Rubber Company to secure its claim against the Fargo Company, then past due:

The resolution closes with:

3. "This company hereby promises and agrees that "WHENEVER it *shall be found necessary for this company to* "*suspend business* it will then assign and transfer to said "Johnson for said Rubber Companies, as additional securi- "ties for their claims against this company (Fargo Com- "pany), all such book accounts, credits, bills receivable and "choses in action as shall be then owned by or due to this "company." (Rec., 62, 63.)

The next step in carrying out the scheme was the resignation of five of the then seven old directors, and the election of George C. Madison, Tiffany Blake, Buell McKeever, Frank B. Fuller and Gilbert E. Porter, clerks and employes in Mr. Beale's office, to fill the vacancies. None of these new directors ever owned a share of stock, or had any personal interest in the Fargo Company. (Rec., 484.)

On the same day McKeever was elected secretary and treasurer of the Fargo Company. (Rec., 64.)

THE NEW DIRECTORS WERE MERE DUMMIES MOVED AT THE WILL OF THE RUBBER COMPANIES.

The Rubber Companies now claim that Mr. Beale's clerks were independent directors, and did not represent the Rubber Companies. The record shows they were selected and were to act (and did act when the crisis came

solely in the interest of the Rubber Companies. (Rec., 488.)

The written draft of the January arrangement itself, the subject of so much discussion between the parties to this fraudulent scheme and afterwards abandoned under the pressure of Johnson's threatening telegram of January 7th, in favor of an "open arrangement" (Rec., 437) which left everything to Johnson's discretion, provides: "*The directors and officers elected at the instance of said Beale * * * are expected to act as may be necessary to guard and protect the interests of said Johnson and of said Rubber Companies.*" (Rec., 588-589.) When the collapse came in August, Mr. Porter called these directors together in his office, and at his command (Rec., 490) they voted the Bank two judgment notes for $25,000 each, and the conveyance of the Dixon plant. Contemporaneously with the doing of these things the Rubber Companies and the Bank entered into a pooling agreement, by the terms of which the Rubber Companies and the Bank were to share *pro rata* in the proceeds of the Fargo property and assets. (Rec., 385.)

None of these directors, excepting Porter, knew at any time why they were elected directors of the Fargo Company, except that they understood, and were informed, in a general way, by the counsel for the Rubber Companies that they were merely nominal directors, and were to act in the interests of the Rubber Companies under the instructions of counsel. Excepting Porter, they knew nothing at any time of the business, or affairs of the Fargo Company; took no personal interest in its financial condition; never went to its premises; made no inquiries as to its affairs, and performed no acts as directors, except those performed under the express orders of the Rubber

Companies' counsel. (Rec., 480, 494.) Their duties were predetermined and fixed in advance by the Rubber Companies, as part of the scheme of control. Their own testimony in the record shows with clearness, that they obeyed the orders of the Rubber Companies, given through their counsel, and performed, and expected to perform no act as directors, except in obedience to such orders. (Rec., 480–481, 490, 493–495.)

When the Fargos wished to take the Metropolitan Bank into the scheme, Mr. Beale stated that the Rubber Companies alone could determine the matter, and sent Fargo to New York to secure authority. (Rec., 562.)

When Mr. Keith, President of the Bank, came to Porter's office in August to make the arrangements by which the Bank was "taken into the deal," he learned, to use his own striking words, that Fargo was a "TOOL IN PORTER'S HANDS" (Rec., 403), and that "THE FARGO COMPANY WAS SUBSTANTIALLY IN THE HANDS OF THE ATTORNEYS OF THE RUBBER COMPANIES." (Rec., 403.)

Having lost all confidence in the solvency of the Fargo Company and in the personal honesty of the Fargos themselves, the two Rubber Companies further insisted upon binding the Fargos, hand and foot, by the following resolution, which was adopted January 9th:

"The president, or in his absence the vice-president, "shall be empowered to sign and indorse ordinary promissory notes and to make and execute contracts, drafts, and "checks for the purpose of carrying on the usual and necessary business of the company; *but no officer or officers "of the company shall have the power to sign, make or execute any mortgage, warrant of attorney to confess judg- "ment, contract or other instrument in writing having the "effect to create a lien or charge, or possibility thereof, upon "the property and assets of the company or any part*

"*thereof, or having the effect to give any creditor or credit*
"*ors of the company any lien, charge or security upon said*
"*property and assets or any part thereof, except pursuant*
"*to the special authority of the board of directors.*" (Rec., p. 66.)

This change in the by-laws was made on Beale's insistence, so as to prevent the president, alone, giving judgment notes. (Rec., 563.) So, likewise, Mr. Beale says: "I "wanted one of the five to be the secretary and treasurer, "because ordinarily, judgment notes would be signed not "only by the president of the corporation, but by the sec- "retary or treasurer. I was willing to take the chances "as against any judgment notes executed by the president "not expressly authorized—affirmatively authorized by the "board of directors." (Rec., 556.)

ABSOLUTE SECRECY WAS ESSENTIAL, AND WAS EXPRESSLY INTENDED, AGREED UPON AND CARRIED OUT, TO INDUCE INNOCENT THIRD PARTIES TO SELL GOODS TO THE FARGO COMPANY ON CREDIT.

Absolute secrecy was essential to the success of the scheme of control finally adopted. Without secrecy, the Fargo Company would be unable to buy a dollar's worth of goods on credit after January.

The Master finds that "the indebtedness of the Fargo "Company, which was incurred after January 9, 1896, " * * * was incurred in ignorance of the * * * "arrangement existing between the Rubber Companies and "the Fargo Company." (Rec., 164.) How this result was accomplished is clearly shown by the evidence.

Mr. Fargo testified, *and his evidence is uncontradicted:*

"*A. Our effort was to keep it secret and we succeeded.*
"*Q. You and your brothers and the other people who*

"*were concerned in this agreement with the Rubber Com-*
"*pany in January, were very desirous of keeping the matter*
"*secret and quiet so that other people could not find it out;*
"*that was the fact, wasn't it? A. Yes, sir.*

"*Q. And this arrangement about the board of directors*
"*and the giving of these judgment notes, in the way it was*
"*done,* WAS FOR THE PURPOSE OF KEEPING THAT MATTER SO THAT
"PEOPLE WITH WHOM YOU WERE DEALING COULD NOT FIND IT
"OUT? *A. Yes, sir.*" (Rec., 426.)

Chattel mortgages were rejected, because placing them on record would ruin the credit of the Fargo Company.

Mr. Beale, in his testimony, stated (Rec., p. 567):

"I did not take for the Rubber Companies a chattel
"mortgage on the stock of goods of the Fargo Company
"for two reasons. First. It was a shifting, changing
"stock. Second. It involved putting the chattel mort-
"gages on record, which would have ruined the credit of
"the Fargo Company."

At first it was suggested that the new directors should include the local agent of the United States Rubber Company and another rubber man, but Fargo told Beale:

"If you should take a man around the street in our line
"of business, they will talk, and at once it will create a
"lot of unnecessary gossip. You know damage can be
"done that ought not to be done, just as damage can be
"done to a woman's reputation by discussing it; that the
"credit of a commercial house is something that can not
"be talked about on the street. If this merchant, or that
"merchant, is put in as a director of this corporation, it
"will arouse some discussion, and I would rather have
"them taken from your office." (Rec., 273.)

Beale testifies that he objected, *because he did not care to have the people in his office taking the responsibility*, but afterwards *acquiesced*. (Rec., 556, 240-241.)

In the early stages of the discussion the parties supposed that four directors out of the seven would be suffi-

cient, but Beale insisted that the Rubber Companies should nominate five directors, to meet the possibility that one might die, and he wanted one of the five *to be secretary and treasurer*, because, ordinarily, judgment notes would be signed by the secretary and treasurer. (Rec., 556.)

Accordingly, five young men, employes in Mr. Beale's office, were selected to constitute the controlling element in the new board of directors. This choice was admirably suited to secure to the Rubber Companies absolute control of the Fargo Company, and at the same time keep the knowledge of that fact from the commercial world. Not only were they clerks in the employ of Mr. Beale, they were in fact (with one possible exception) lawyers themselves. Blake, one of the dummy directors and a young lawyer, testified that he considered it a "*professional matter*" (Rec., 489), and for that reason he did not deem it proper to mention the matter to his brother, who was an employe of the Fargo Company. Indeed, he says that at one of the "meetings" "one of the gentlemen" asked *him not to say anything to his brother about it.* (Rec., 489.) The new secretary and treasurer of the company were likewise chosen from these employes.

Up to this time the three Fargos had been the executive heads of the Company; it was necessary to maintain that position in the public eye, so that the fundamental change in the condition of the Fargo Company might not be disclosed to the world. Accordingly, Charles E. Fargo was retained as president, and Frank M. Fargo was to pose before the public as treasurer; it was secretly agreed that he should perform, as before, all the treasurer's duties, though of course no "official" action was taken in the matter. (Rec., 570.) *In the correspondence afterwards carried on by the Fargo Company with its creditors and the*

public generally, printed letter heads were used on which the officers of the Fargo Company were named as before, viz: Charles E. Fargo, president; Edward A. Fargo, secretary, and Frank M. Fargo, treasurer. (Rec., 353.) This was done with knowledge of all the parties to this fraudulent scheme.

The desperate anxiety of the parties to keep the scheme secret is well illustrated by the testimony of the Rubber Companies' counsel as to the interview between himself and Fargo in July. Mr. Beale says (Rec., 561) that in the middle of July Fargo told him he had a note coming due at the Bank, which the Bank insisted should be paid; that he could not go to Keith, the President, and explain why he could not pay because there would be some "*embarrassing questions*" asked. After discussing this distressing situation, Beale and Fargo finally decided, *that Fargo should put a new note in a letter written to the Bank, so as to have the entire information contained in the letter, in order not to have any "embarrassing questions" asked;* this was done, and the note extended accordingly. Even the Bank was ignorant of the altered condition of affairs until August, when Charles E. Fargo asked permission to disclose the facts to Keith, and take the Bank into the scheme, in order to enable him to borrow $10,000 for himself and his brothers to "live on." (Rec., 191–192.)

Late in July or early in August, a $10,000 note matured at the Bank, and Fargo told the Rubber Companies that he would not ask a renewal, unless the Bank was informed of the arrangement and taken care of *because he did not feel it would be quite square or honest to do so.* As to the Bank, such conduct would be dishonest, these parties confess, but

boldly declare that under the same circumstances, to buy merchandise on credit was fair and legitimate trading.

The record, as a whole, discloses that when the January scheme was launched, it was not only the design, and an essential part of the scheme that it should be kept secret, but it was in fact kept secret at all hazards, for the express purpose of inducing innocent traders to give credit to the Fargo Company.

THE COURSE OF DEALING SUBSEQUENT TO THE JANUARY SCHEME.

The January scheme put the Rubber Companies firmly in the saddle. They had secured not only secret, but absolute control of all the then existing and after-acquired assets of the Fargo Company, and complete dominion over its corporate powers. In the words of Mr. Beale himself, "*The Fargo Company was entirely in the hands of the "Rubber Companies*" (Rec., 438). Charles E. Fargo, as president, Edward A. Fargo, as vice-president, and Frank M. Fargo as "acting" treasurer, continued to pose in public as the managers of the concern; kept open its office and place of business, and ostensibly conducted its affairs, seemingly as before; used in their correspondence with the Rubber Companies and also with the concerns from whom they were purchasing goods on credit and borrowing money, printed letter-heads bearing the false statement that F. M. Fargo was treasurer, and Edward A. Fargo secretary; while, as a matter of fact, during all that time, Buell McKeever, the representative of the Rubber Companies was secretary and treasurer. By these means the Fargos and the Rubber Companies preserved the credit of the Fargo Company, and enabled it to purchase, during the succeeding six months, great quantities of merchandise from the Respondents, *which must have constituted the*

bulk of the property levied on by the Marshal under the Rubber Companies' executions.

THE RUBBER COMPANIES EXTENDED LITTLE OR NO CREDIT TO THE FARGO COMPANY AFTER THE JANUARY SCHEME.

The Rubber Companies, however, after they had bought and secured secret control carefully refrained from taking any further chances, or in any way sharing the risk they compelled other creditors to take. The Candee Company did not sell or consign the Fargo Company a dollar's worth of merchandise after January. The United States Rubber Company sold the concern only $600 worth on credit, and consigned it only $18,000. (Rec., 544, 545.) That this was not accidental, but carefully designed, is shown by Mr. Beale's letter to Sadler, under date of May 5, 1896, in which he says: "THERE IS ONLY ONE THING ABOUT WHICH I "WISH TO CAUTION YOU IN THIS CONNECTION, AND THAT IS NOT "TO LET THE FARGO INDEBTEDNESS INCREASE, BECAUSE ANY "SUCH INCREASE PROBABLY WOULD NOT BE PROTECTED BY THE "JUDGMENT NOTES." (Rec., 591, 592.) The title to these consigned goods, under the new precautions devised by counsel, remained in the Rubber Companies, and they could easily retake at any time, all unsold goods. The business world, however, deceived by the false appearance of things, extended credit aggregating over $246,660.54. (See Master's Report, Rec., pp. 161, 163.) The proof in this case discloses that all the liabilities of the Fargo Company existing in August, to creditors other than the Rubber Companies and the Bank, were created subsequent to the January scheme. (Master's Report, Rec., p. 163.)

THE RUBBER COMPANIES KNEW, WHILE THE COMPLAINING CREDITORS WERE BEING "DRAWN IN" THAT THE FARGO COMPANY MUST "GO TO THE WALL."

These claims, including those of the Respondents, and other creditors who proved up before the Master, exceed $180,000. (See brief p. 87 and Rec., 137, 138, 141.) This course was deliberately persisted in for six months, in spite of the knowledge frequently brought home to the Rubber Companies that the Fargo Company was merely staggering along from day to day and month to month, in a hopelessly embarrassed condition. The letter from the Fargo Company to Sadler, dated April 27, 1896 (Rec., 581), shows that the Fargo Company's receipts during April "*were one-third less than their calculation, "and forty per cent. less than the preceding year, and that "this was likely to continue.*" And yet up to this time, the Fargo Company had paid $40,000 to the Rubber Companies, and $5,000 the following month, so that practically the whole of the $50,000 January loan went back to the Rubber Companies within four months after the same had been advanced. Much of the merchandise for which the Fargo Company is now indebted, was purchased after this letter was written, and *the claim of the American Oak Leather Co., exceeding $12,000, was entirely created after March 14, 1896.* (Rec., 324.) (Master's Rep., Rec., p. 167.) Moreover, the resources of the Fargos were drained by heavy and constant payments to the Rubber Companies. There was paid to the United States Rubber Company, on June 22, $5,000; on July 8, $5,000; July 20, $5,000; and at this very time, in June and July, the Fargos were procuring extensions from the Respondents, on grossly false representations (Rec., 326, 327), and were protesting to the Pfister

& Vogel Leather Company that they could do nothing to pay, or secure its claim, fortifiying their protestations with like false statements. (Rec., 318.)

The Fargos likewise, between January and August, *paid off and took up all the paper on which* (in January) *they were liable as endorsers* for the Fargo Company, and thus succeeded in their design to free themselves from personal liability. (Rec., 215.)

The Rubber Companies *received between January 6th and August 6th over $60,000*, besides the $100,000 worth of rubber goods.

FRAUDULENT AND DECEITFUL REPRESENTATIONS MADE BY THE FARGOS TO THE DIXON BANKS AND OTHER CREDITORS AFTER JANUARY IN ORDER TO OBTAIN MONEY AND GOODS ON CREDIT.

The course of dealing, and the intentions of the parties to these transactions, can best be illustrated by calling attention to the fraudulent representations repeatedly made after the January scheme had been entered into, in order to induce innocent persons to loan the Fargo Company money and sell it goods on credit during the period in which the Rubber Companies were conducting its corporate movements. It is true that most of these representations, so far as the record discloses, were personally made by the Fargos, but this was to be expected, nor does this fact put the Rubber Companies in any better light. It was not to be supposed that the Rubber Companies themselves would be engaged in making representations (in person), false or otherwise, as to the condition of the Fargo Company. Their connection with that concern was intended to be, and was in fact, kept absolutely secret. They were in control of the Fargo Company through its board of directors.

They turned the Fargos loose upon the community to secure merchandise and money on credit, by any means which they might see fit to employ. The efforts of the Fargos in that direction, were a direct benefit to the Rubber Companies. It was an essential element of the scheme that every dollar's worth of merchandise which the Fargos could procure on credit, would go to swell the available assets out of which the Rubber Companies could make their claims at their discretion. Every act of the Fargos in furthering this fraudulent end, is directly chargeable to the Rubber Companies.

We have already called attention to the fact that in the entire correspondence of the Fargo Company, both with the Rubber Companies and with the creditors generally between January 6th and August 6th, the Fargos used printed letter heads containing positive, false representations as to the officers of the company. These letter heads are shown in the record at page 384. They read as follows:

"*Chas. E. Fargo, Frank M. Fargo, Edward A. Fargo,*
Prest. V. P. & Treas Secty.
C. H. Fargo & Co.
Manufacturers of Boots and Shoes
196, 198, 200 Market Street, Chicago."

These letter-heads constituted material, false representations of matters of fact. During the time that they were used, Frank M. Fargo was not treasurer, nor was Edward A. Fargo secretary of the company. On the contrary, the dummy secretary and treasurer, Buell McKeever, secretly held both of these offices. A number of representatives of concerns who gave the Fargo Company credit during this period testified as to the receipt of letters with these letter-heads, and that the printed matter thereon created the im-

pression in their minds that no change had occurred in the management of the Fargo Company, but that the three Fargos continued as before, in sole control. If, in lieu of these false statements, the letters had contained the truth, namely: that Buell McKeever, a clerk in the office of the Rubber Companies' counsel, was both secretary and treasurer of the Fargo Company, suspicion, amounting to certainty, would at once have been created, that something was wrong with the management of the concern.

FALSE REPRESENTATIONS BY THE FARGOS TO THE DIXON BANKS.

The first tangible act which the evidence shows to have been performed by these parties after the January scheme was set in motion, consisted in false representations and false pretenses, whereby the Fargo Company obtained large loans of money from banks with which they had formerly done practically no business, and to which they had never previously applied for credit. Early in February, Frank M. Fargo, fraudulently *posing as the treasurer of the Fargo Company*, went to Dixon, where the factory was located, and applied to the Dixon National Bank and the City National Bank for loans. Up to this time these banks had never loaned the Fargo Company any money. To allay suspicion he told the two banks that the Company wanted the money to build an addition to its Dixon factory, which would result in larger employment of local labor and contribute to the growth and development of the town; that under the circumstances the Dixon banks ought to be willing to advance the money for that purpose. (Rec., 305.) He further assured them that the Company's business was in good shape; that it had never been so prosperous; that it *had no judgment notes outstanding*, and no mortgages or anything of that kind. (Rec., 303-316.)

On these false representations and false pretenses Fargo induced the banks to loan the Company $17,000. The items are proved up before the Master and are allowed in the decree in this case. It is true that the Company thereafter, for the purpose of keeping up appearances, made a small addition to its Dixon factory, but certainly only a nominal amount, if anything, of the sums so borrowed, was used for this purpose. The total cost of the addition did not exceed $7,000 (Rec., 251), *and this could never have been paid for*, because mechanic's liens, which were afterwards foreclosed, swept away the entire Dixon plant. (Rec., 252.)

False Representations by the Fargos to the Pfister & Vogel Leather Company.

In July, 1896, the Pfister & Vogel Leather Company had a claim of about $17,000 for goods sold after February, 1896, and the Fargo Company had applied for an extension. In connection with this application, Mr. Vogel, of that company, came to Chicago and had an interview with Charles E. Fargo on July 21. (Rec., 318.) This date, it will be remembered, is the one upon which the Fargo Company paid $5,000 to the United States Rubber Company, and is the date upon which the note matured which Mr. Beale telegraphed to the Rubber Companies, would cause the failure of the Fargo Company, unless an extension was secured. The extension was secured by the questionable *device of mailing the renewal note to the bank without any explanation*, and thereby avoiding "*embarrassing questions.*" (Rec., 561.) Mr. Vogel's account of what took place in this conversation with reference to his inquiries of Fargo as to the financial condition of the Company, is as follows:

"I says, 'Are you really solvent?' He says, 'I have "got two dollars for every one that I owe.' * * * I "says, 'Have you got any judgment notes out, or has any "body got any preferences here?' He says, 'No.' (Rec., "318.) I had pressed him for a statement. * * * "He then told me that they were in the midst of an inven- "tory, and that they would furnish that statement very "shortly. That statement never came." (Rec., 319.)

After this testimony was given Fargo was placed on the stand by the Rubber Companies. In his testimony, while endeavoring to mitigate the bald falsity of the statement to which Vogel testified, he admitted that the latter must have understood from the conversation that the Fargo Company had no judgment notes out, and admitted also *that he endeavored to give Vogel that impression.* (Rec., 419, 425.)

False Representations to the Commercial Agencies.

To cap the climax, Charles E. Fargo furnished a statement to Dun's Agency, as a basis for general credit, about June 9, 1896, which reads as follows (Rec., 327.)

"Mr. C. E. Fargo now gives us the following figures showing condition as per inventory May 1, 1895, which was the last taken:

ASSETS.

Merchandise	$245,438 89
Printing and stationery	1,100 00
Insurance	1,400 00
Furniture and fixtures	6,500 85
Factory at Dixon	110,262 66
Real Estate	2,223 09
Accounts receivable	366,359 08
Cash	5,869 38
	$743,153 95

LIABILITIES.

Bills payable	$167,589 31	
Accounts payable	158,925 43	
		$326,514 7
Net surplus		$416,639 2

Says condition would probably not be materially change at present, * * *."

This statement was made the basis of a report by Dun' Agency, and furnished to the trade generally, among others to the American Oak Leather Company; that company, in reliance upon this monstrously false statement, extended from June until September and October, notes aggregating $7,000, part of its claim now in judgment. (Rec., 326.)

CORRESPONDENCE BETWEEN THE FARGO COMPANY AND THE RUBBER COMPANIES AND THEIR COUNSEL AFTER THE JANUARY SCHEME WAS LAUNCHED.

Some of the correspondence between the parties is disclosed in the record. These letters and telegrams were offered by the defendants themselves, and it is safe to assume that only those most favorable to Petitioners' contention, were presented. A careful consideration of this correspondence throws considerable light upon the course of dealing and intentions of the parties. The material extracts are as follows:

"CHICAGO, April 27, 1896.

"*Mr. H. M. Sadler:*

"* * * *The receipts this month, which are one third "less than our calculations, and 40 per cent. less than in the "same time last year. This is likely to continue.* * * *

"*This, of course, contemplates the payment in cash, as fast* "*as collected, for present and future sales. We have now* "*paid about $40,000 of your notes just matured, and have* "*$5,000 to pay next month, which shall be paid outside* "*foregoing.* We are pushing hard on old accounts, *but* "*they come in very slowly.* * * *

C. H. FARGO & CO.
(Rec., 581.) CHARLES E. FARGO."

Within a few days after this letter was received in New York, Mr. Beale wrote from Chicago the following warning letter to his client, which was evidently inspired by their receipt of information showing that the crisis was approaching.

"CHICAGO, May 5, 1896.

"*H. M. Sadler, Jr., Esq.:*

* * * "Sometime ago the indebtedness upon an "open account to the United States Rubber Company was "put into the form of a note or notes, and I remember say- "ing either to you, or Mr. Johnson at that time, that I "thought a letter ought to be written by the Fargo Com- "pany or Mr. C. E. Fargo saying that it was the *intention* "*that the judgment note in favor of the United States Rub-* "*ber Company should secure the indebtedness in whatever* "*form it might stand, and whether absolute or contingent.* "I am now under the impression that you did not obtain "such a letter at the time, *but I still think, as a matter of* "*precaution, it would be worth while to have such a letter* "*to meet possible future questions, in case the Fargos should* "*hereafter go to the wall. I propose to prepare two such* "*letters as I have in mind,* one to be addressed to the Can- "dee Company and one to be addressed to the United "States Company, to be signed by the Fargos as stock- "holders * * * With the new notes properly distrib- "uted between the two companies, *and with such letters, I* "*do not see why the companies are not as safe as human* "*foresight can well make them, without closing down on the* "*Fargo Company and driving it out of business.* * * *

WILLIAM G. BEALE.

"P. S.—Since dictating the above, I have telephoned "Mr. Fargo to explain to him * * * He expresses "an entire willingness to have the matter in such shape as "will be satisfactory and safe for us, and will accordingly "send such letters as we may prepare * * * *There is "only one thing about which I wish to caution you in this "connection and that is not to let the Fargo indebtedness in-"crease, because any such increase probably would not be "protected by the judgment notes.* W. G. B."
(Rec., 591.)

The following letters of May 14th and 15th, are apparently those prepared by Mr. Beale:

"CHICAGO, May 14, 1896.

"*Mr. H. M. Sadler, Jr.:*

* * * "We beg to say for the purpose of preventing "any question about the matter, that it was our under-"standing and the understanding of all concerned, at the "time the judgment notes were executed * * * that "such judgment notes should be collateral to, and security "for any and all liability * * * whether evidenced "by open account or by other notes which might be given "for such liability thereafter. * * *

C. H. FARGO & CO.
CHARLES E. FARGO,
President."

(Rec., 583.)

"CHICAGO, May 15, 1896.

"*Mr. H. M. Sadler, Jr.:*

* * * "We understand also that the judgment notes "you hold, will protect you fully in respect to any contin-"gent liability upon any notes of C. H. Fargo & Co. "which you may have discounted, or may discount. *This "is a suggestion from Mr. Beale's office, which we are glad "to follow.*

C. H. FARGO & CO.
CHARLES E. FARGO,
President."

(Rec., 584.)

"May 16, 1896.

"*Wm. G. Beale, Esq.:*

"Your favor of the 14th inst. came duly to hand. Thanks "very much for the detailed information and instructions "covering the whole situation. *We will be very careful "and guided accordingly.*

"Regarding the consignment stock which Fargo had "been selling since January 1, I understood from him "when in Chicago, that he was keeping separate books "and collecting the money and placing it to a special ac- "count in his bank, as per his agreement, and that he "would forward us in a few days, a check for the amount "collected. * * *

H. M. Sadler, Jr."

(Rec., 593.)

Telegram.

"Chicago, July 16, 1896.

"*To H. M. Sadler, Jr.:*

"Metropolitan Bank has asked Fargo Company, because "of alleged tight money market, to pay note for ten "thousand dollars, due July 21st. Fargo Company una- "ble to pay and extension may be refused. *Fargo promi- "ises to keep me informed so that if necessary, judgments "can be entered on our judgment notes.* Better wire me "amounts now owing respectively to United States and "Candee Companies, including any discounted notes on "which they are liable as endorsers. *Better also wire me "authority to take whatever steps I may think necessary for "protection of companies. Possibly you or Mr. Johnson "better come here.*

William G. Beale."

(Rec., 593.)

Telegram.

"New York, July 16, 1896.

"*Wm. G. Beale:*

"Will be in Chicago Sunday night and see you Monday "morning with all papers relating to Fargo situation; judg

"ment notes will cover amount due this company at pres-
"ent time as far as we know; should any action be required
"before I arrive, use your best judgment for interests of
"this company.

H. M. SADLER, JR."

(Rec., 594.)

TELEGRAM.

"CHICAGO, July 17, 1896.

"*To H. M. Sadler, Jr., New York:*

"Fargo advises us has just received pleasant letter from
"Metropolitan Bank agreeing to extend note due on 21st
"instant. This apparently leaves matter all right for the
"present.

(Rec., 594.)

WILLIAM G. BEALE."

The "pleasant letter from the Metropolitan Bank" was probably the result of the convenient arrangement testified to by Beale and Fargo under which Fargo put a new note in a letter and sent it to the Bank, so as to have all the information contained in the letter and to avoid "embarassing questions," which might be asked by President Keith if Fargo requested the renewal in person. (Rec., 561.)

THE INDEBTEDNESS OF THE FARGO COMPANY AT THE TIME OF ITS FAILURE, AUGUST 6, 1896.

The Master finds that the total unpaid indebtedness incurred after January 6, 1896, was $142,690.95 (Rec., 163), which is an error, and is nearly $40,000 less than the claims actually proved up and filed with the Master under the order of the Circuit Court, entered March 11, 1897, and by him reported on May 29, 1897, as having been actually filed with him pursuant to said order. (Rec., 137.) The claims so filed aggregate $180,037.53.

The Master fell into this error by following the report of the accountant Cooper, who testified that *the books of the Fargo Company* showed the indebtedness—at the time of the failure—to be $142,690.98. (Rec., 458, 460 and 461. But Cooper admits that the books did not contain *all the claims*, and that he had no knowledge as to whether the books were or were not correct (Rec., 467), and declares that some of the necessary books were missing. (Rec., 468.) The record does not disclose who secreted or destroyed these books. They were last known to be in the possession of the Fargos. They were important books, and consisted of one ledger, inventory books, balance records, etc. No testimony was introduced to show that the Fargo Company books, on which Cooper based his estimate of liabilities, were correct. Cooper's testimony shows that he was merely stating his estimates from what he saw in the books which he had before him, and the finding of the Master based on his testimony must fall. The record shows conclusively that under the order of March 11, 1897, claims to the amount of nearly $40,000, *in excess of the Master's findings*, were actually filed with him.

To these claims amounting to $180,037.53, so filed with the Master, must be added the liens on the Dixon plant; these liens were so large that when foreclosed the Bank refused to redeem the property for which it had paid $25,000, by cancelling one of its two judgment notes. While the record is silent as to the amount of these liens, it seems to us to be a fair and reasonable inference that they must have been large and probably equal to the purchase price paid by the Bank for the equity in the Dixon plant. If these liens be added to the total indebtedness of the Fargo Company at the time of its failure, and the amount of such liens be fixed at $25,000, then the total

indebtedness at that time reached the figure of $205,037.53, instead of $142,680.98 as erroneously found by the Master.

THE CONSUMMATION OF THE JANUARY SCHEME AND THE FINAL COLLAPSE OF THE FARGO COMPANY.

The crisis which seemed impending in the middle of July was not avoided, but only postponed a few days by the "letter expedient" then adopted to deceive Keith into renewing the $10,000 note. By this device the parties avoided, for the time, answering "embarassing questions," and succeeded in securing the desired extension. Their keen anxiety and appreciation of the critical condition of affairs is sufficiently shown by the telegrams of July 16th and 17th (see pp. 37–38 *supra*) which passed between Mr. Beale and Mr. Sadler at this time. At the end of July matters again got desperate. Another $10,000 note was coming due at the Bank which could not be met, and Fargo had a talk with Mr. Beale about having this note extended and borrowing $10,000 of new money from the Bank. (Rec., 208.) Fargo says he felt that *it would not be honest to borrow this new money from the Bank without disclosing the January arrangement* and taking the Bank into the scheme. (Rec., 209.) When it was suggested that it would be best to take the Bank in, the Rubber Companies' counsel told Fargo that he must go to New York and *get the consent of his clients to the proposed arrangement*. Fargo went to New York the last day of July, saw Sadler, told him that unless the Bank's note was extended the Fargo Company would have to go overboard. (Rec., 189.) Sadler consented that the proposed arrangement with the Bank should be made. (Rec., 209.)

But no negotiations looking to this proposed loan were actually entered into with the Bank until August 4th, and

in the meantime the note in question matured on August 2nd, and its renewal was obtained without any apparent difficulty. (Rec., 189.) By what trick this note was renewed is not disclosed by the record. Fargo says: "I simply sent and had it renewed." (Rec., 189.)

The final crisis came on August 4th. Fargo had an interview with Mr. Porter, at which they evidently came to the conclusion that the Fargo Company could not be kept afloat any longer, and it was arranged between them that Fargo should procure $10,000 from the Bank, not for the purposes of the business, but to be turned over to the Fargos for their personal use. (Rec., 449, 265.) Fargo accordingly went to Keith and made a full disclosure of the situation. (Rec., 191.) Upon that disclosure the Bank deliberately paid the $10,000 to be taken into the January scheme, and on the same day agreed with the Rubber Companies to close up the Fargo Company and appropriate all its assets, sharing in the proceeds *pro rata*. Sadler's consent to this arrangement was obtained by Porter over the telephone. (Rec., 451.) After this arrangement had been determined upon matters proceeded very rapidly.

On August 5th Mr. Porter called into his office the dummy directors, and by his commands (Rec., 490) a resolution was passed by these dummies authorizing the giving of two judgment notes to the Bank, not for $40,000—the amount of its true claim—but for $50,000 ($25,000 each), which included the proposed fraudulent $10,000 payment; another resolution passed at the same time and in the same way, authorized the conveyance to the Bank of the Dixon Plant (real estate) located at Dixon, Illinois, for an expressed consideration of $25,000, but in satisfaction of one of the Bank's $25,000 judgment notes. (Rec., 67. Two judgment notes for $25,000 each were immediately

executed and delivered to the Bank; one was at once cancelled and surrendered back to the Fargos in payment of a conveyance of the Dixon Plant. (Rec., 198, 199.) *After all this had been done*, the Bank paid over the $10,000 to the Fargos, and not before. All these things were done at the same time, and for the same purposes. (Rec., 453.) As Mr. Porter testified: "WE HAD IT ALL PROGRAMMED OUT IN ADVANCE." (Rec., 453.)

On August 6th a resolution was adopted by the stockholders (not by the directors), pretending to authorize a transfer of all the book accounts to the two Rubber Companies. These accounts, without any action by the board, were then attempted to be assigned, and together with all the books of the Fargo Company, were "delivered" to the Rubber Companies. Simultaneously judgments were entered by confession in the United States Circuit Court: one in favor of the United States Rubber Company for $145,400; one in favor of L. Candee & Co. for $38,300; and one in the Circuit Court of Cook County in favor of the Metropolitan Bank for $25,000. These three judgments were entered at the same time and in concert, but it was arranged that the Marshal should be put in possession under the Rubber Companies' judgments, before the Bank's execution was placed in the Sheriff's hands, probably in order to avoid the danger of replevin suits, to which the property would have been subject had the actual levy been made by the Sheriff. (Rec., 457.) Accordingly, executions on the Federal judgments were at once levied by the United States Marshal on the Company's merchandise at Chicago and at Dixon.

The property so seized was afterwards sold. The Chicago merchandise realized, at public sale, $65,000, which sum, less expenses, etc., has been turned over to the re-

ceiver in this cause. The merchandise and chattel property at Dixon were bid in by, and sold to the United States Rubber Company for $15,000, but were afterwards turned over to the receiver and sold by him for $12,500.

THE CONVERSION OF THE CONSIGNED GOODS BY THE RUBBER COMPANIES.

While the Marshall was in possession, the consigned goods on hand, amounting to over $100,000, were taken out of the Fargo's place of business, by the Rubber Company's agent, and shipped back to New York. (Rec., 539.)

THE NEGOTIATIONS AND AGREEMENT BY WHICH THE METROPOLITAN BANK WAS TAKEN INTO THE SCHEME TO SHARE PRO-RATA WITH THE RUBBER COMPANIES IN ALL THE FARGO ASSETS.

On the afternoon of August 4, 1896, Fargo saw Porter, and stated to him that he intended to go to the bank and borrow $10,000. (Rec., 441.) Fargo then called on Keith at the bank and had the first interview concerning the proposed $10,000 loan, telling Keith that the Fargo Company would have to fail, and *that he and his brothers wanted the $10,000 to live on.* (Rec., 191.) Keith swears that Fargo told him that the Fargos had previously borrowed $10,000 elsewhere, and had pledged certain bank stock, which they owned personally, as collateral, and that they needed the $10,000 to redeem the bank stock. (Rec., 389.) That this was an individual matter, and he thought he ought to have the money to take care of the note (Rec., 389); and that Fargo told him that having put the money into the firm's business he thought he was entitled to have the firm pay it back to him. (Rec., 393.)

Whatever the facts may be as to just what language was used by Fargo in his talk with Keith, it is perfectly clear from this record that Keith was fully advised at the time of this first interview *that the Fargo Company must immediately fail, and that the $10,000 was desired for the benefit of the Fargos individually.* The affidavit filed by Mr. Keith on the former hearing is worth considering at this point. In this affidavit Mr. Keith claims, with more or less evasiveness, that the $10,000 was loaned to the Fargo Company to *assist that firm in prosecuting its legitimate business* and *to relieve its financial distress.* (Rec., 659.)

If there be one thing clear in this record, it is that the $10,000 was paid over on August 5 or 6, *after the judgment notes were actually given to the bank, and after Fargo had been authorized to sell the Company's plant to the Bank, and after this sale had been actually consummated.* The resolution authorizing the execution of the judgment notes was not passed until the afternoon of August 5. (Rec., 67.) At this same meeting of dummy directors, Fargo stated that he had "begun negotiations" with the Bank for the transfer of the Company's Dixon plant for $25,000, and a resolution adopted at that meeting authorized him to consummate the sale. The transfer was immediately carried into effect, the judgment notes confessed and the accounts assigned. At the very first interview between Fargo and Keith, the latter knew that the Fargo Company would have to go to the wall. (Rec., 192.)

After this interview, Keith, in company with the Bank's counsel and Jones, visited Porter's office and there learned that the Rubber Companies were preparing to enter up judgments (Rec., 391), that five out of seven of the directors were young men in Beale's office, and that, in the language of Keith himself, "*Fargo was a tool in Porter's hands, and*

"*the Fargo Company was substantially in the hands of the "attorneys for the Rubber Companies.*" (Rec., 403.)

Before the $10,000 loan (so-called) was consummated or paid over to Charles E. Fargo, the Fargo Company was in the actual throes of dissolution, and the Bank and the Rubber Companies had already agreed in a formal written instrument to unite their efforts to collect their respective claims, and that the result of their efforts should be distributed in the proportion of their respective claims, including the fraudulent $10,000 paid by the Bank to the Fargos personally; that if either party received a larger percentage on his claim than the other, as a result of their united efforts, he would account to such other party for a sum sufficient to make the percentage of payments of their respective claims equal. (Rec., 385.)

Specifications of Error.

The errors and cross errors assigned upon the record, present three questions:

First. Were the Petitioners *guilty of any fraud whatever?*

Second. Were the Petitioners *guilty of constructive fraud?*

Third. Were the Petitioners *guilty of actual fraud.*

Guided by *Hubbard* v. *Tod*, 171 U. S., 494, the Respondents applied to this court for *certiorari*, which was granted. The whole record, including all assignments of error filed in the trial court and considered by the Court of Appeals, is now here.

The case of *Hubbard* v. *Tod supra*, we respectfully suggest, leaves it in some doubt, as to whether this court on *certiorari* to the Court of Appeals, after final or

der or decree considers that final order or decree, or the decree entered in the Circuit Court.

Respondents have therefore, (for the convenience of the court, so as not to encumber this brief), printed the errors, (being very full and specific), assigned by them to the original decree of the Circuit Court, under separate cover, accompanying this argument. The errors and cross errors will be found in the record at large. (Rec., 645, 646, 667–692.)

We therefore, respectfully ask the court, if our assignments of error to the decree of the Circuit Court are to be specifically considered, that the court will refer to the printed specifications of error accompanying, and hereby made a part of this brief.

BRIEF OF THE ARGUMENT.

I.

The January Scheme was Fraudulent as to all Creditors, and Especially Fraudulent as to the "Drawn in" Creditors who parted with their Property after the Scheme was Launched.

The scheme disclosed by this record shocks the conscience. In its opinion (Rec., 725) the Court of Appeals said: "*As a judicially sanctioned, or commercially accepted possibility in business, it is unbelievable.* "It could be attempted only by a corporate debtor; and "its approval by the courts would afford a new and fruitful motive for the creation of corporations by the many, "who would be quick to avail themselves of so promising "a method of pursuing hazardous enterprises at the risk of "others."

This rugged characterization presents the scheme in all its nakedness.

The concrete form into which the January machinery was finally thrown, was invented by the parties with the express design of obtaining the same unconscionable advantages over innocent creditors, which secret chattel mortgages and like fraudulent devices would have given them. The Rubber Companies' counsel believed that the January scheme would give his clients all that secret chattel mortgages and like devices would have given them, without the risk and hazard surrounding such instruments. The testimony of Beale and Porter, who originated the scheme (Rec., 444) shows that secret chattel mortgages and like devices were

carefully canvassed and promptly rejected (Rec., 444), because without the publicity of recording, the security would be worthless against other creditors; and if recorded, the credit of the company would in the words of Mr. Beale, be ruined. On this subject, Mr. Beale says: "*I did not take for the Rubber Companies a chattel mortgage on the stock of goods, for two reasons: First: it was a shifting, changing stock; and secondly: It involved putting the chattel mortgage on record, which would* RUIN THE CREDIT OF THE FARGO COMPANY." (Rec., 567.)

In the language of the Circuit Court of Appeals:

"The scheme adopted, which, if upheld, though not constituting a recognized form of lien, would be a better security than a chattel mortgage, was accepted, not only because it made secrecy possible, but because it made exposure impossible, if those employed to execute it, kept faith." (Rec., 725.)

It is doubtful if any of the innumerable schemes invented to defraud creditors and which have been condemned by the courts, give to their inventors advantages so directly destructive of the rights of innocent third parties, as the fraudulent machinery disclosed by this record. The scheme adopted by the Rubber Companies may justly be characterized as novel and original, the like of which, so far as diligent search enables us to speak, was never before conceived, or put into actual use. Fortunately, courts of equity have always refused to confine themselves to any limited definition of fraud, and this record is only another striking illustration of the wisdom of such refusal.

Lord Hardwicke, in his letter to Lord Kames of the 30th of June, 1759, (Parke's Hist. of Chanc. P., 508), says:

"Fraud is infinite, and were a court of equity once to lay down rules how far they would go, and no farther,

"in extending their relief against it, or to define strictly "the species or evidence of it, the jurisdiction would "be cramped and perpetually eluded by new "schemes which the fertility of man's invention would "contrive."

1 Story's Eq. Juris. (11 Ed.), Sec. 186, Note 5.

* * * * *

The "January scheme," when analyzed, discloses the following elements:

1. The Rubber Companies thereby obtained and exercised the power to convert at their pleasure, all existing, all after-acquired, all tangible, and all intangible property of the Fargo Company, and appropriate the proceeds to the exclusion of all other creditors.

2. The Rubber Companies secured absolute power to prevent (at their sole discretion) the Fargo Company from preferring, or paying any other creditor.

3. While the Rubber Companies were in possession and control of the corporate powers and assets, the Fargos were to be held out, and were in fact held out to the world as being in actual control of the Company and its property.

4. The Fargos were permitted, for an indefinite period, to buy, sell and ostensibly carry on the business as they saw fit, until the Rubber Companies, *in the exercise of their discretion*, elected to appropriate the assets to their own use, and shut out all other creditors.

5. Creditors other than those favored by the Rubber Companies, were absolutely prevented from obtaining "any mortgage, warrant of attorney to confess judgment, "contract or other instrument in writing, having the "effect to create a lien, or charge, or possibility "thereof, upon the property and assets of the Company,

"or any part thereof, or having the effect to give any "creditor or creditors of the Company any lien, charge or "security upon said property and assets, or any part "thereof." (See Fargo Co. resolution of January 9th, Rec., p. 66.)

6. Creditors other than the Rubber Companies could not obtain liens by executions until long after the Rubber Companies had appropriated all the assets to their own use.

7. And finally, the scheme was to be kept secret by all the parties, and was actually kept secret for the express purpose and with the express result of inducing innocent third parties to sell the Fargo Company merchandise on credit, at the sole risk of such third parties.

This analysis discloses that the Rubber Companies acquired by the January scheme all the advantages they could have obtained by a chattel mortgage (kept secret by agreement between the parties) on a stock of going merchandise, reserving to the mortgagor the apparent possession and apparent dominion over the property, with the permission to continue business by selling and appropriating the proceeds at his discretion until the mortgagee should see fit to foreclose.

But the scheme in question secured to the Rubber Companies greater and more inequitable advantages and powers than could be obtained even by such a secret chattel mortgage, viz.:

First. It brought within their secret grasp, control and practical possession, not only all the existing chattels and accounts of the Fargo Company, *but also all after acquired tangible and intangible property.*

Second. It gave the Rubber Companies control over the

volition of their debtor, and rendered that debtor powerless to do justice to other creditors; and thereby

Third. It enabled the Rubber Companies to escape the risk which the law compels the holder of an unrecorded chattel mortgage to assume, viz., the risk that his secret lien may be defeated by the prior record of a junior encumbrance.

This risk, among others, the policy of the law compels the prior mortgagee to assume, if, through accident, inadvertance or mere negligence he fails to record his prior mortgage. (*Field* v. *Ridgely*, 116 Ill., 424.) But where the security, in whatever form it may exist, is given with the express understanding that it is to be "kept secret," the law visits a more drastic punishment upon the parties to the transaction by declaring the lien, or security to be fraudulent in fact as against innocent "drawn-in" creditors. By the scheme here adopted, the Rubber Companies sought to secure all the advantages of a secret mortgage, and at the same time avoid these risks. To that end the Fargo Company was tied hand and foot, and placed in the secret possession of the mortgagees; at the same time, it was permitted to remain in the ostensible possession and control of its assets, and thereby put in a position to delude the commercial world by the fictitious standing and credit thus dishonestly begotten. This scheme and the resulting advantages, were possible only with a corporate debtor.

II.

The Rubber Companies Understood that the Fargo Company could not go on in Business Without Future Credit; that Credit could not be Secured if the January Scheme were disclosed; it was Vitally Essential that Absolute Secrecy should be Maintained to Secure such Credit, and Absolute Secrecy was by agreement Maintained, for that specific purpose, until the final Collapse in August.

If the Fargo Company could not purchase goods on credit, all parties understood that its doors must be closed. It is monstrous for counsel to even suggest that the parties did not understand, or intend secrecy to be a vital and essential element of the scheme itself.

The Master finds that "the matter was kept secret in "order to allow the Fargo Company an opportunity of get-"ting through embarrassments apparently temporary." (Rec., 162.) This means, and can only mean, that they were to continue the business under a plan, which, without secrecy, was known to be impossible, and by which the risks of the business were shifted wholly upon innocent creditors who parted with their property in ignorance of the true situation. True, the Master says "the plan was "kept secret, but not with a fraudulent intent as to the "other creditors of the Company." The Master differs widely from Charles E. Fargo, who declared to Mr. Beale in July that he would not ask the Metropolitan Bank to renew a $5,000 note without disclosing the whole scheme, because TO DO SO WOULD HAVE BEEN DISHONEST. (Rec., 209.)

When the renewal of another bank note was under consideration, Mr. Beale himself agreed with Fargo that it would

not be safe to ask the Bank for such extension, because its President, Mr. Keith, might ask "embarrassing questions;" and thereupon, Beale and Fargo agreed to send the renewal note by mail, and thus avoid the necessity of disclosing the secret (Rec., 561.)

Charles E. Fargo stated under oath that the January scheme was, by agreement, kept secret for the specific purpose of enabling his company to obtain credit. This is nowhere denied or challenged. Not a witness has dared to contradict him. This is what Fargo says:

"A *Our effort was to keep it secret and we succeeded.*
"Q. *You and your brothers and the other people who were*
"*concerned in this agreement with the Rubber Company in*
"*January, were very desirous of keeping the matter secret*
"*and quiet so that other people could not find it out; that*
"*was the fact, wasn't it?* A. *Yes, sir.*
"Q. *And this arrangement about the board of directors*
"*and the giving of these judgment notes, in the way it was*
"*done,* WAS FOR THE PURPOSE OF KEEPING THAT MATTER SO
"THAT PEOPLE WITH WHOM YOU WERE DEALING COULD NOT
"FIND IT OUT? A. YES, SIR." (Rec., 426.)

Blake, one of the dummy directors and a young lawyer, testified that he considered it a "*professional matter*" (Rec., 489), and for that reason he did not deem it proper to mention the matter to his brother, who was employed by the Fargo Company. Stronger than his own view of the secret character of the transaction, is the statement he makes that at one of the director's meetings "*one of the*
"*gentlemen asked him not to say anything to his brother*
"*about it.*" (Rec., 489.)

To keep faith with Beale and Johnson and preserve the January scheme inviolate, Fargo confesses that he deliberately deceived Pfister & Vogel, as to the existence of the January scheme (Rec., 425), and thereby secured renewals;

that he deceived the American Oak Leather Company, Dun's Mercantile Agency, the Eagle Tanning Works, and all creditors who had the right to seek, and did seek information concerning the situation and condition of the Fargo Company. Frank M. Fargo denied the existence of the January scheme and thereby deliberately deceived the Dixon banks and secured $17,000, two months after the scheme had been launched.

Did the Rubber Companies expect the Fargos when asked by their creditors concerning the condition of the Company, to disclose the January arrangement, or did they expect them to equivocate and deceive? If the Fargos had told the truth to inquiring creditors, Johnson and Beale must have known that their plan would collapse, and the Company would be unable to secure a single dollar of additional credit. Credit was expected, intended and absolutely necessary to the success of the plan; therefore, Beale and Johnson must have known, if they gave the subject any thought, that the Fargos must and would equivocate and deceive when questioned by their creditors. The Rubber Companies and their representatives put the Fargos in a position where the latter were forced, either to deceive their creditors, or make known the January scheme. As reasonable men, Johnson and Beale must be presumed to have had in mind and considered, the natural and probable consequences of such false and deceptive conduct. They are therefore responsible in law and in morals for every false statement made by the Fargos after the January scheme was set in motion.

As throwing a flood of light upon this subject, and showing that Beale and Johnson did consider the question we have just discussed, we direct attention to an interesting passage in the opinion of the Circuit Court of Appeals. (The italics are our own):

"After explaining that he (Beale) had personally cau-
"tioned Charles Fargo against being too hopeful, * * *
"he added, 'I was particularly desirous that through any
"strong temptation he (Fargo) should not put the Metropoli-
"tan Bank *in a position where it could claim to have been*
"*deceived*. I do not think that the idea of other creditors
"—merchandise creditors, or their position—entered the
"mind of either Mr. Johnson or Mr. Sadler or myself
"during the entire transaction: we were thinking of the
"Metropolitan Bank and were anxious to see that that
"indebtedness should not increase after we made the
"arrangement, and that subject—reference to the Metro-
"politan Bank—formed the subject of some conversation
"between Johnson and myself, and I distinctly remember at
"one of the interviews at the Auditorium Annex saying
"that Fargo after that must not go to the Metropolitan
"Bank to borrow additional money.'

"One creditor at least, was important enough to be
"thought of and talked of, and to be the object of solicit-
"ous care, that 'through any strong temptation' Fargo
"should not put it (the Bank) in a position where 'it could
"claim to have been deceived.' What stronger con-
"demnation could there be of the scheme, or better proof
"that its essential character was apprehended, (though
"unconsciously, according to the Master's finding) by
"those about to put it into operation? There were potent
"reasons for thinking of the bank, and for desiring that it
"should not have ground for asserting deceit. Mercantile
"creditors were farther away, and individually, of much
"less importance, it is easy to see, than the Bank. * * *
"But all that, only emphasizes the wrong done in for-
"getting others equally entitled to consideration, *if they*
"*were forgotten*, and if they were purposely left out of
"consideration, still greater was the wrong." (Rec., 726.)

The testimony and the Master's report show that the secrecy in this case was a secrecy kept for the specific purpose of enabling the Fargo Company to secure merchandise on credit at the sole risk of the merchant or manufact

urer. It was *premeditated secrecy;* without such secrecy the January scheme was impossible. Beale, Porter and Fargo, the active factors in this enterprise, admit in their testimony that secrecy was indispensible, and secrecy was preserved. Says Mr. Beale, "PUBLICITY WOULD RUIN THE CREDIT OF THE FARGO COMPANY." (Rec., 567.)

That such a secret scheme, deliberately entered into, and carried out, constitutes nothing less than actual fraud, would seem to need no argument.

The Illinois authorities which we discuss at some length, (pages 120–130 of this brief), present an unbroken front on this proposition. They hold without exception, that when an agreement exists by which a chattel mortgage or kindred lien is to be kept off the record, or otherwise kept secret, such agreement vitiates the security, and, in the language of Judge Mulkey, in the *Haas—Sternbach* case, is a "*a wicked conspiracy to defraud creditors.*"

In discussing an analogous state of facts, where a mortgage was kept off the record "with the express purpose "and intent on the part of the mortgagees, * * "of giving them (the mortgagors) this fictitious credit and "standing, to no other possible end than that they should "thereby be enabled to deal with, and to the detriment of "others, to contract debts, to gain extension of old debts," * * the Supreme Court of Alabama says:

"We can not be in doubt that the transaction is tainted "with *actual fraud*, which will vitiate it as against subse- "quent creditors, and the like, who have been drawn into "contractual relations with the mortgagors by assuming "their apparent, to be their real status, with respect to "the property covered by the mortgage, and this result "follows, notwithstanding the conveyance is free from in- "firmity in every other respect."

Lehman v. *Van Winkle*, 92 Ala., 443.

Likewise, the Supreme Court of the United States, by Mr. Justice Woods, said, in *Blennerhassett* v. *Sherman*, 105 U. S., 107:

"So, in *Hillard* v. *Cagle* (46 Miss., 309), it was held "that a deed of trust in the nature of a mortgage, valid on "its face, and not made or received with any intent to "defeat existing or future creditors, may nevertheless be "held to be fraudulent and void as to all creditors, existing "and future, by evidence *aliunde*, showing the conduct of "the parties in their dealings in reference to the deed. "The principal circumstance relied on in this case to avoid "the deed was the fact that the grantor retained posses- "sion of the property and the deed was withheld "from record, and the mortgagor was thereby enabled "to contract debts upon the presumption that the prop- "erty was unincumbered. The court declared that the "natural and logical effect of the agreement and assign- "ment, and the conduct of the parties thereto, was to mis- "lead and deceive the public, and induce credit to be given "to the mortgagor, which he could not have obtained if "the truth had been known, and, therefore, the whole "scheme WAS FRAUDULENT AS TO SUBSEQUENT CREDITORS, AS "MUCH SO AS IF IT HAD BEEN CONTRIVED FROM THAT MOTIVE "AND FOR THAT OBJECT."

The Supreme Court of Colorado in another like case says:

"When the grantor of a trust deed and the beneficiary "agree together that the trust deed is not to be recorded "as provided by law, that it may not affect the financial "standing of the grantor, THE EVIDENT FRAUDULENT INTENT "BECOMES EXPRESS."

Stock Growers' Bank v. *Newton*, 13 Colo., 255.

In another Colorado case the facts in many respects are very strikingly similar to the case at bar. H. P. Walton, being indebted to his brother, E. T. Walton, arranged that he should be secured, at all hazards. The creditor brother

suggested that the debtor should give a judgment bond, but the latter objected to having the bond entered of record, saying that a judgment, or anything so public, would affect his credit. Finally, the debtor gave the creditor brother a confession of judgment, which it was agreed should be kept secret and should not be filed in court until the failure of the debtor.

In the opinion, the case of *Smith* v. *Craft*, 17 Fed. Rep., 705, is distinguished, on the ground (among others) that in the latter case there was no security given at the time the agreement to prefer was made, and no promise to keep the same secret, and, concluding, the court say:

"The transaction between the Waltons in this case is "deemed FRAUDULENT, not merely on the ground that E. "T. Walton continued to give credit and make advances to "his brother when he knew him to be insolvent, for he had "a right to trust his brother to any extent in the ordinary "course of business without imperiling his legal right to "secure his debt. Neither is the transaction to be deemed "FRAUDULENT merely on the ground that he took a confes- "sion of judgment for his debt: for he had a right in the "ordinary course of business to receive a confession of "judgment on account of a lawful debt at any time, but "the FRAUDULENT CHARACTER OF THE TRANSACTION CONSISTED "IN appellant's taking the security he did under an agree- "ment that it should be kept from the public, that is, not "entered of record, so long as the collection of appellant's "debt was not thereby imperiled, thus deliberately giving his "brother a fictitious financial standing in his known failing "circumstances, and placing him in a position to perpetrate "fraud by obtaining credit, as in case of appellee, which "would otherwise be withheld, while appellant held a con- "fession of judgment with which to protect himself when "others had trusted his brother and were helpless.

* * * * *

"While the witholding of a confession from the record "for a considerable length of time may not be necessarily

"fraudulent, an agreement between the party giving and "the party receiving such an instrument, that it shall be "kept from the public, or that it shall not be entered of "record for an unreasonable or indefinite time, IS ONE OF "THE STRONGEST BADGES OF FRAUD."

Walton v. *First National Bank*, 13 Colo., 265.

"Such a transaction is *fraudulent* as to other creditors."

Goll & Frank Co. v. *Miller*, 87 Iowa, 426.

"It was held by this court in *Goll* v. *Miller*, 87 Iowa, "426, that such a transaction was *fraudulent* as to other "creditors and that case was followed by *Falker* v. *Line-* "*han*, 88 Iowa, 641."

Liddle v. *Allen*, 90 Iowa, 738 (1894.)

See also to the same effect the authorities discussed, *infra*, pp., 112–119, and

Davis v. *Schwartz*, 155 U. S., 631.
Sanger v. *Guenther*, 73 Wis., 354.
Standard Paper Co. v. *Guenther*, 67 Wis., 101.
Blakeslee v. *Rossman*, 43 Wis., 116.
Bank v. *Doran*, 109 Mo., 40.
Thompson v. *Van Vechten*, 27 N. Y., 568.
Parshall v. *Eggert*, 54 N. Y., 23.
Karst v. *Gane*, 136 N. Y., 320.
Stephens v. *Perrine*, 143 N. Y., 477.
Crippen v. *Fletcher*, 56 Mich., 386.
Fearey v. *Cummings*, 41 Mich., 383.
Cummings v. *Fearey*, 44 Mich., 39.
Wallen v. *Rossman*, 45 Mich., 333.
Shipman v. *Seymour*, 40 Mich., 274.
Meding v. *Roe*, N. J. Chy., Nov. 5, 1894, 30 Atlantic Rep., 587.
Bank v. *Newton*, 13 Colo., 245.
Hungerford v. *Earle*, 2 Vern. 261.

Hildreth v. *Sands*, 2 Johns (N. Y. Ch.,) 35.
Scrivenor v. *Scrivenor*, 7 B. Mon. (Ky.), 374.
Bank of U. S. v. *Housman*, 6 Paige (N. Y.), 526.
Coates v. *Gerlach*, 44 Pa. St., 43.
Haffner v. *Irwin*, 1 Ired., (N. C.) L., 490.
Hildeburn v. *Brown*, 17 B. Mon. (Ky.), 779.
Neslin v. *Wells*, 104 U. S., 428.
Hoagland v. *Wilson*, 15 Neb., 320.
Steel v. *Coon*, 43 N. W. Rep., 411.
Barker v. *Barker*, 2 Wood, 87.

Moreover, wherever chattel mortgages or arrangements of that nature present the fraudulent features here under discussion, it is the universal doctrine that the fact, that the mortgagee may have taken possession before execution or attachment liens have been acquired, does not strengthen his position against persons who have advanced credit subsequent to the execution of the mortgage, and pending the period during which it has been kept off the record by agreement, or whatever may be equivalent thereto.

III.

The Intent and Motives of the Parties in Concluding and Executing the January Scheme were Fraudulent in Fact, though there may not have been present a Conscious, Personal Intent to Defraud.

To hold that the "January scheme" was fraudulent in fact, as to "drawn in creditors," it is not essential that the parties should have been primarily moved by a wicked and corrupt purpose to enter upon the course of dealing in question, to cheat and defraud other creditors. Nor is it necessary to charge the

Petitioners with a deliberate and corrupt conspiracy to procure goods in the name of the Fargo Company, in order to swell the assets, out of which the Rubber Companies might make their claims at the expense of other creditors.

Even if it were true that the uppermost thought of the Rubber Companies was to obtain at all hazards, absolute security, and the Fargos were primarily moved by a desperate anxiety to escape their personal liability as endorsers, nevertheless their motives and intentions would still be nothing less than actually fraudulent. For the record demonstrates that among the motives and intentions which actuated and controlled the Fargos and the Rubber Companies, both in creating and carrying out the January scheme, there was conspicuously present a general design and deliberate intention;

1. That the scheme should be kept secret;

2. That all persons dealing with the Fargo Company should continue to believe that the corporation was standing on its own feet, with no change in its corporate management or control.

3. And that a false credit might thereby be preserved to the Fargo Company.

Clear it is that the parties intended, and indeed, expressly stipulated, that the claims of the U. S. Rubber Co. should be paid off as rapidly as possible, and the Candee Company's notes paid absolutely as they matured, without extension; they must have intended that the proceeds of the goods obtained on credit after January, should be utilized as far as possible, in the payment of the Rubber Companies' claims; and finally they must have intended that the goods themselves, and the accounts created by their sale, should go to swell the assets, out of which, the Rubber Companies

intended to make their claims when the threatening collapse occurred. (Statement pp. 17–18.)

Moreover, whether the Rubber Companies had accurate information in January as to the assets and liabilities of the Fargo Company or not, they certainly possessed the firm inward conviction that its affairs were in such a desperate condition as to imperatively demand on their part the most extraordinary and cumulative precautions, and the exhaustion of legal ingenuity in devising the "absolute" security so persistently demanded by Johnson—"absolute" (Rec., 590) security for all their claims, direct and indirect, absolute and contingent. (See statement, p. 17, for detailed analysis of said precautions.) On the one hand, they had determined that they themselves would run no risks of any kind; on the other, that the commercial world generally should be deluded into assuming all the hazards which the January scheme involved.

Of course, the record is full of the usual protestations of innocent and laudable motives; but the parties must be judged by their acts, and not by their protestations, after their wrong-doing has been discovered and laid bare.

The facts are hopelessly against them when they set up the claim that the $50,000 advance in January was a loan, made by a creditor to help a debtor out of embarrassments believed to be merely temporary. The $50,000 advance was the price paid by the Rubber Companies in January to secure an unconscionable advantage. In this respect, it stands on the same footing as the $10,000 paid in August by the Bank to be taken into the scheme. In each instance, the money paid represents the purchase price of the advantage secured.

When Johnson and Sadler were advised, at the first Auditorium interview on January 2nd, that the Fargo Company

was in distress and would go to the wall immediately, unless it received assistance, they made no offer to help the Fargos. On the contrary, they not only manifested a perfect willingness that the Fargo Company should immediately fail, but even a keen desire then and there to force the failure, and appropriate its property to the payment of all their claims. They instantly demanded that their own claims should be preferred as a matter of right. The most generous mind can see nothing in the case so far, showing any desire on the part of the Rubber Companies to assist the Fargo Company in its financial struggles. When were Johnson and Sadler transformed from grasping creditors, eager for immediate preferences, into good Samaritans, desirous of helping the Fargos in their distress? The fact is, that Johnson and Sadler never manifested the slightest willingness to advance the Fargo Company a dollar, until they knew from the lips of Charles E. Fargo, *that if the Company had to go to the wall, all creditors would be dealt with on an equality.* This would involve the Rubber Companies in a certain and immediate loss of over $200,000. The stream can not rise higher than its source. (Statement, p. 11.)

The sole ground of the Rubber Companies' conclusion to make this advance, was the certainty that refusal would involve them in an immediate calamity. Their motives in making the advance can not be considered higher than the very purpose which moved them to do so. In other words, the Rubber Companies were driven by the necessity of the situation, to purchase the preference (which had been refused), and pay therefor the $50,000 loan, not money, but merely credit. Can an advance made under these circumstances, be considered for a moment as a voluntary loan made by a creditor to a struggling debtor?

If there was any doubt as to the true character of this $50,000 advance, the real motives of the Rubber Companies in the transaction would be clearly disclosed by their conduct after they got the judgment notes in their possession, and the Fargo Company thus in their power. The Fargos, anxious though they were to procure the money at any cost, nevertheless, tried to make an advantageous bargain, and continued to struggle against the drastic demands of Johnson and his counsel.

At the outset, the Fargos had the whip hand in the negotiations, and utilized their position to compel Johnson to purchase all the advantages which he obtained, and insisted on an elaborate written agreement definitely limiting the rights of the Rubber Companies. The contest between Fargo and Johnson over the terms of this written agreement was prolonged for days; until, in fact, the condition of the Fargo Company became so acute as to make it absolutely necessary for them to have $10,000 at once. Accordingly, $10,000 was handed over on January 6th and the judgment notes executed and delivered to Mr. Beale. Then the tables were turned. The Rubber Companies, with the judgment notes in their possession, were in a position to dictate terms and put an end to Fargo's protests. It seems, however, that the Fargos did not at first appreciate the change in the situation produced by the execution and delivery of the judgment notes, for they still protested against the final surrender of all their powers, and objected to signing the written agreement itself, unless the judgment notes should bear some indorsement showing the terms upon which judgment might be confessed.

Johnson had left for the east on January 6th. Before he reached home he had heard from Sadler, of Fargo's contin-

ned obstinacy. Recognizing that the possession of the judgment notes had put him in a commanding position, whereby he was able to dictate terms to the Fargos, Johnson immediately, before reaching New York, telegraphed peremptory instructions to Mr. Beale to enter up judgment on all the judgment notes, unless the Fargo Company made a complete and immediate surrender of their corporate powers. (See statement, p. 15.) Under this threat the Fargos succumbed, and *agreed to leave everything to the direction of Johnson.* Is this the conduct of a creditor who is desirous of helping a struggling debtor? Johnson's telegram is utterly inexcusable from any point of view. Least of all, is it possible to harmonize his attitude with his present benevolent protestations. The simple fact of the matter is, that Johnson, keenly realizing the precarious condition of the Fargo Company, was frightened at the very thought of further delay. Under the circumstances he had obtained a splendid bargain for his employers, and fearing to lose the advantages thus gained, threatened to wreck the Company immediately, unless his position should be made at once absolutely secure.

Johnson's telegram to Beale is one of the most significant facts in the record, and reads as follows:

"*Your position should be made absolute as soon as pos-*
"*sible, by completing agreement as arranged, and organ-*
"*ization of Board of Directors. * * * Failure to thus*
"*protect us, should result in executions by us. Use at your*
"*discretion, all judgment notes in your possession in order*
"*to put our claim beyond peradventure.*" (Rec., 554.)

That telegram stands out conspicuously, like the scheme adopted to extend the Bank's note in the middle of July, by sending a renewal note in a letter, so as to avoid "unpleasant questions." Items of evidence like these open up *vistas*, wherein the motives and objects of the parties can

be clearly discerned. Certainly the Rubber Companies can not be heard to say that they believed in January that the embarrassments of the Fargo Company were only temporary. The actual course which they pursued was precisely that which would have been adopted if they had in fact known that the financial condition of the Fargo Company was one of hopeless insolvency.

It is extraordinary that during the week in which Johnson and Sadler remained in Chicago, quartered only a few blocks from the Fargo store, and while engaged with their counsel in exhaustive efforts to devise some scheme which would procure absolute security, *they made no effort to get at the actual facts.* With every means of information right at hand and open, they turned away and closed their eyes to the light. (Statement, p. 13.)

The reason for this seeming indifference is clear. Forced liquidation in January would have paid the Rubber Companies, on a *pro rata* basis with other creditors, less than twenty-five cents on the dollar. Had the Rubber Companies then declined to buy control they would have lost in a general crash over $200,000.

But by purchasing control, the Rubber Companies would have the entire assets of the Fargo Company (plus the $50,000 of credit advanced) to apply upon their claims then aggregating $284,000. By lending their credit to the extent of $50,000, the Rubber Companies would, in any event, not only be secured as to the $50,000, but would also save the greater part of their old debt of about $284,000. Accordingly, "absolute" security for all claims, old and new, direct and contingent, was peremptorily and unconditionally demanded by the Rubber Companies as the sole condition on which they would ad-

vance the $50,000 and buy control of the Fargo Company. (Rec., 502, 511, 523.)

Mr. Johnson's instructions to his counsel about the absolute and unconditional character of the security the Rubber Companies demanded appear repeatedly in this record, and show that this was the uppermost thought in his mind, and was created by his firm conviction that the Fargo Company was then hopelessly insolvent and unable to avoid financial collapse. (Rec., 502.)

If anything more were needed to show the utter want of confidence on the part of the Rubber Companies and their representatives in the Fargos, the unusual precautions taken with respect to the consigned goods fixes the matter beyond all debate. For a quarter of a century the Rubber Companies had consigned their rubber goods aggregating millions and millions of dollars. In January, for the first time in their long and intimate dealings with each other, the Rubber Companies demanded the "absolute security" which crops out in almost every page of this record. The January scheme, among other things, provided:

1. That the consigned goods should be separated by themselves on the sixth floor. (Rec., 340, 342.)

2. That a separate bank account should be opened for all sales of rubber goods and special account books should be kept of such sales. (Rec., 427, 428.)

(See statement, p. 17.)

Nothing like these precautions, and in fact, no precautions had ever been taken in the course of the whole quarter of a century dealings between these parties. If the Rubber Companies believed that the distress of the Fargo Company was merely temporary, if they had faith in the honesty of the Fargos, is it reasonable to suppose that they would have

insisted upon these extraordinary measures, which, if their present proclamations of faith and confidence be true, were insulting to the honor and personal integrity of the Fargos themselves?

Under this January arrangement the Rubber Companies had everything to gain, and nothing to lose. From their point of view it would not have made any difference whether Johnson and Sadler had or had not investigated the assets and liabilities of the Fargo Company in January; in either event they would have taken the same course. Johnson's conduct shows that he thought the less he knew about the real situation the better standing the Rubber Companies would have in any future legal inquiry, a suggestion which clearly explains why Johnson wilfully shut his eyes to any definite information regarding the assets and liabilities, when the means of full information were ready at hand.

In determining what actual knowledge the Rubber Companies had as to the real condition of the Fargo Company, the phraseology in the first resolution adopted on January 6, by the Fargo directors in carrying out the January scheme, is important. In the closing paragraph of this resolution drawn by the Rubber Companies' counsel on their behalf occurs the following:

"*And this company hereby promises and agrees that* "WHENEVER *it shall be found necessary for this company to* "*suspend business, it will then assign and transfer to said* "*Johnson for said Rubber Companies, as additional securi-* "*ties for their claims against this company, all such book* "*accounts, credits, bills receivable and choses in action as* "*shall be then owned by, or due to this company.*" (Rec., 62, 63.)

An early suspension of business was contemplated by this resolution. The words above emphasized, would not have

passed unchallenged if an early suspension had not been regarded as highly probable.

That the insolvency and suspension of the Company must have been discussed and gravely considered by all parties, is established beyond controversy by the testimony of Beale and Porter. Said Mr. Porter (Rec., 446-7):

"*The reason which actuated Mr. Beale and me to have "the judgment notes made by the old board instead of the "new, and have them delivered prior to the change in the "board of directors was that we considered it better to do so, "because of the application of the rule* THAT A DIRECTOR OF "AN INSOLVENT CORPORATION *is not allowed to secure any "benefit to* SOME ONE WHOM HE REPRESENTS. We looked up "several cases, among them that of *Blair* v. *Illinois Steel "Co.*"

Considering the facts disclosed by this record, it is inconceivable that if Johnson had, in good faith, believed the Fargo Company solvent, or able to continue its business, he and his counsel would have devised the extraordinary arrangement shown in this case. They might have taken judgment notes, as they did during the panic of 1893; but to insist upon the bodily transfer of the corporate assets and corporate powers to the two Rubber Companies as security, is indisputable proof that the hopeless insolvency of the Fargo Company was well understood by the Rubber Companies and their agents, and that their repeated protestations of confidence in the Fargos are wholly without foundation. They believed neither in the assets, nor in the personal honesty of the Fargos. What Johnson did, was to the letter, what he would have done had he believed the Fargo Company hopelessly insolvent and the Fargos dishonest men. He could have done no more. His intentions must be measured by his acts, and not by his protestations.

Johnson and Beale were profoundly solicitous about the Metropolitan Bank. They repeatedly cautioned Fargo to borrow no money from that institution. Here is what Beale says, as to why he and Johnson were so anxious that Fargo should not borrow any money from the Bank, after the January scheme (Rec., 563-4):

"*I was particularly desirous that through any strong "temptation he (Fargo) should not put the Metropolitan "Bank in a position where it could claim to have been de-"ceived.*"

The Bank was a big institution and on the ground. It would fight, because its claim was large enough to justify an expensive legal contest. The general creditors, whose claims were as a rule small in comparison, could more easily be held at bay.

Thus we have Beale and Johnson's deliberate judgment in January that for Fargo to go to the Bank after the January scheme was launched, and borrow more money, would put the Bank "*in a position where it could claim to have "been deceived.*" According to their code of morals, it would seem perfectly proper for the Fargos to get hundreds of thousands of dollars worth of merchandise on credit, but to borrow a single additional dollar from the Bank would be dishonest. This distinction is beyond our understanding.

In July, when Beale and Fargo found it necessary to secure a renewal of one of the Bank's notes for $5,000, Fargo peremptorily refused to secure such renewal, because, as he says, *he felt that it would not be honest to secure such renewal from the Bank without disclosing the January arrangement and taking the Bank into the scheme.* (Rec., 209.) Mr. Beale then acquiesced in Fargo's condemnation of the January scheme so far as the Bank was concerned. Why was the scheme dishonest as to the Bank, and at the

same time fair and honest as to the deluded creditors who are the respondents here?

PERSONAL, CONSCIOUS INTENT TO DEFRAUD NOT ALWAYS NECESSARY TO CONSTITUTE ACTUAL FRAUD.

But after all, the personal, conscious intent of the parties to the transaction is wholly immaterial. The scheme was, and is, *per se*, fraudulent *in fact*. Its natural and logical effect was to mislead and deceive the public, and to induce credit to be given to the Fargo Company, which it could not have obtained if the truth had been known, and therefore, the whole scheme, even if the motives of the Rubber Companies could possibly be said to have been innocent, was in every respect actually fraudulent as to the creditors complaining here; as much so as if it had been organized with that sole motive and object in view.

All men are conclusively presumed to have intended the usual and natural results of their actions, and neither in criminal, nor in civil law can one be heard to say that his motive in doing an unlawful act was, so far as his own conscience was concerned, innocent. The use of the term "constructive fraud," or "legal fraud," in such a case, is misleading.

A scheme bearing striking points of resemblance to the facts disclosed by this record is elaborately discussed by the Supreme Court of Mississippi, in *Hilliard* v. *Cagle*, 46 Miss., 309. After reviewing the facts the court say:

"The testimony does not convince us that the arrange-
"ment was made with a fraudulent scheme and purpose to
"defeat existing or future creditors. This was not the
"primary motive. Summers & Brannin desired that
"Baggett should continue his business as before,
"but at the same time they were anxious that they

"should be protected at all events, and in any contingency. "If misfortune and calamity should fall upon him, their pur- "pose was to be secure."

And yet the court holds that this could make absolutely no difference:

"In ascertaining the motive, we look through the conduct, "and from it make the deduction and inference. Generally, "this is the only mode of conducting the inquiry. A man "must be conclusively taken to intend the natural and logi- "cal results of his acts. Upon this principle rests his ac- "countability for the violation of criminal laws. It is equally "applicable in civil affairs. If one is actually misled to his "prejudice and loss, by the conduct of another, the injury to "him is just the same as though the thing were done for the "very purpose of deceiving."

Ib., 338.

And reviewing all the actions of the parties, the court concludes:

"We are of opinion that the natural and logical effect of "the agreement and assignment, and the conduct of the "parties thereto, was to mislead and deceive the public, and "induce credit to be given to Baggett, which he could not "have obtained if the truth had been known, and therefore "the whole scheme was fraudulent as to subsequent creditors, "as much so as if it had been contrived with that motive "and for that object."

Ib., 345.

This conclusion is approved and relied on by this court in *Blennerhasset* v. *Sherman*, 105 U. S., 100.

See also to the same effect numerous cases cited *supra*, pp., 52-60.

So Bigelow says in his leading work on Fraud:

"It is not uncommon, however, to speak of cases in which "there is an absence of any personal intention to defeat "creditors as cases of 'constructive fraud.' The main ob-

"jection to the term is that it suggests, if it is not founded "upon the notion that the 'intent' of the statute is in reality "a personal intent. In so far as it may be designed to indi- "cate that the court disclaims the purpose of *fastening a "stigma upon the debtor,* where his conduct was not base, "the use of the term, or of its cognate, 'legal fraud,' is well "enough. But when the *effect* of intended fraud in the pop- "ular sense is produced, it is for legal purposes confusing "and misleading to speak of the act as something short of "fraud."

2 Bigelow on Fraud, pp. 378-379.

Again, it is said in Wait on Fraudulent Conveyances and Creditor's Bills, Section 8:

"The act may be adjudged covinous although the parties "deny all intention of committing a fraud, and it is not "necessary to impute to the parties '*a premeditated or "wicked intention to destroy or injure*' the interests of "others. A man may commit a fraud without believing it "to be fraud. The statute 13 Eliz., refers to a legal, and "not a moral intent; that is, not a moral intent as contra- "distinguished from a legal intent. It supposes that every "one is capable of perceiving what is wrong, and therefore, "if he does that which is forbidden, intending to do it, he "will not be allowed to say that he did not intend to do a "prohibited act. A man's moral perceptions may be so per- "verted as to imagine an act to be fair and honest which the "law justly pronounces fraudulent and corrupt. * * * "Whenever the effect of a particular transaction with a "debtor is to hinder, delay, or defraud creditors, the law "infers the intent, though there may be no direct evidence "of a corrupt or dishonorable motive, but on the contrary, "an actual honest motive existed. The law interposes, and "declares that every man is presumed to intend the natural "and necessary consequences of his acts: and the courts "must presume the intention to exist when the prohibited "consequences must necessarily follow from the act, and "will not listen to an argument against it. Hence it has

" been remarked that where a conveyance by its terms oper-
" ates to hinder, delay, or defraud creditors, the intent to do
" so is imputed to the parties, and no evidence of intention
" can change that presumption. A different intent cannot
" be shown and made out by the reception of parol testimony,
" nor deduced from surrounding circumstances."

Ib., Sec. 9.

To the same effect see

Pierce on Fraudulent Mtges. of Mdse., p. 5, Sec. 3.

It is shown by this record, that the arrangements made were put in the form which they actually assumed, because that was *the only form* in which the results desired could be accomplished and yet kept secret; that the methods used were adopted *for the purpose* of keeping the arrangements secret, in order that credit might be obtained, and that they were in fact *kept secret* and credit in fact secured. (Statement, *supra*, pp., 22-23.)

Under the authorities, therefore, the whole scheme " was
" fraudulent as to subsequent creditors as much so as if it
" had been contrived with that motive and for that object."
But a scheme contrived with " that motive and for that ob-
" ject " would be within the strictest meaning of the term
" actually fraudulent."

To repeat the language of Bigelow, " It is for legal pur-
" poses confusing and misleading to speak of the ' scheme '
" as being something short of fraud. It is ' actual fraud.' "

IV.

By the January Scheme the Rubber Companies in Fact and in Equity Usurped Secret Control of the Fargo Company and Thereby Assumed the Fiduciary Relation of Directors.

The seemingly serious contention found in Respondents' brief that Mr. Beale's five clerks were independent directors, and were not mere dummies for the Rubber Companies, shows to what extremes counsel have been driven. The record discloses the fact that these five directors were young law clerks in his office and used by Mr. Beale, who had exclusive charge of all these arrangements and dealings, for the express purpose of effectuating his clients' ends; counsel expressly recognized that he was personally responsible for the acts and conduct of these young clerks; that they followed implicitly the orders given by Beale, or his representative, Porter; that the only time when a performance by them of any affirmative act was discussed, Beale expressly stated that he had no power to pass on the question, and that the Rubber Companies alone could determine the matter; that only after this action was agreed to by the Rubber Companies themselves, did these dummy directors perform the act in question, and then simply registered the volition of the Rubber Companies on the subject. (Statement, *supra*, p., 40.)

Nor is there any merit in the claim that these dummy directors were to do nothing, and in fact did nothing. If this were true, such pre-determined non-action would amount to affirmative action, and an affirmative breach of a trust imposed upon them as directors, to the advantage of

their employers, and to the prejudice of other creditors. But the fact is that when the final collapse came, when the emergency occurred to meet which this machinery was created in January, these directors did act affirmatively, for the direct benefit and upon the order of the Rubber Companies. They were called in by Porter, and by his orders, voted the judgment notes and the conveyance of the Dixon plant to the Bank, both of which were for the direct benefit of the Rubber Companies, and constituted a direct preference to them; for at the time these things were voted, a solemn written agreement had been entered into between the Rubber Companies and the Bank, expressly providing that the Rubber Companies should share *pro rata* in the proceeds of the Dixon property and the Bank's judgment. (Statement, pp. 40-43.)

To sum up, the avowed object of the arrangement, the admitted method of accomplishing this object, and the conceded results, were precisely the same as if the Rubber Companies had fraudulently and secretly constituted themselves directors of the Fargo Company, for the sole purpose of secretly controlling the volition of that company for their own benefit, and thereby secretly holding all its assets within their grasp, and at the proper time seizing and appropriating these assets to their own use and benefit. The Rubber Companies were corporations, and therefore could not directly assume the office and function of directors. Moreover, they did not dare permit any of their own personal employes to assume this relation, lest the essential element of secrecy might be impaired. The objects and results aimed at could have been accomplished by the method adopted, and by no other.

"The situation here may be summed up in the words of "Vice Chancellor Kindersley in *Attorney General* v. *The*

"*Northern Railway Co.*, 1 Drew & S., 157, 6 Jur. N. S., "1,006, 29 L. J., 794: 'A more flimsy device, when the "particulars are once known, it is impossible to imagine. "* * * It must not be thought that courts are power- "less to strip off disguises that are designed to thwart the "purposes of the law; the mere suggestion of such a con- "dition is an insult to the intelligence of the judiciary: "whenever such disguises are made apparent, they can "readily be disrobed. The difficulty is in showing the dis- "guises, not in penetrating them when they appear.'"

Stockton v. *Railroad Co.*, 50 N. J. Eq., 75; 17 L. R. A., 107.

See particularly the opinion, rendered February 23, 1897, by Mr. Justice Wallace, sitting in the Circuit Court of Appeals for the Second Circuit, in

Siddel v. *Missouri Pac. Ry. Co.*, 78 Fed., 726.

Where it is said:

"When a majority of the stockholders of a corporation "combine to effect some predetermined scheme of corporate "action, and by their vote select a body of directors to carry "it out, they practically constitute themselves the corpora- "tion for that particular object, and assume the fiduciary "relation which the directors themselves occupy. *Ervin* v. "*Navigation Co.*, 27 Fed., 625; *Farmers' Loan & Trust Co.* "v. *New York & N. Ry. Co.*, 150 N. Y., 410, 44 N. E., "1043. The same result follows when one individual, or a "corporation, exercises this control by its majority voice and "vote. If the corporation is insolvent this trust relation "towards creditors forbids the majority stockholder from "appropriating for his own advantage the property or fund "in which all have a community of interest. *Jackson* v. "*Ludeling*, 21 Wall., 616."

So in a leading case in Michigan, Chancellor McGrath said:

"Defendant Lorman must be held to have made these "contracts with himself. He directed, influenced and con-

"trolled the board. They had no personal interest in the "affairs of the company, and exercised not their own judg- "ment and discretion, but Lorman's will. * * *"

Miner v. *Belle Isle Co.*, 17 L. R. A., 412; 93 Mich., 97.

See also

Ervin v. *Oregon Railway and Navigation Co.*, 27 Fed. Rep., 625.

Chicago Hansom Cab Co. v. *Yerkes* (Ill.), 30 N. E. Rep., 667.

Woodruff v. *Howes*, 26 Pacific Rep., 111.

Meyer v. *Staten Island Co.*, 7 N. Y. State Rep., 245.

1 Beach Corp., 276.

Smith v. *Los Angeles Imm. & L. C. Asso.*, 78 Cal., 289.

San Diego v. *San Diego & L. A. R. Co.*, 44 Cal., 106.

Bill v. *Western Union Teleg. Co.*, 16 Fed. Rep., 14.

Copeland v. *Johnson Mfg. Co.*, 47 Hun., 235.

Davis v. *Memphis City R. Co.*, 22 Fed. Rep., 883.

Sellers v. *Phoenix Iron Co.*, 13 Fed. Rep., 20.

Currier v. *New York, W. S. & B. R. Co.*, 35 Hun., 355.

Jackson v. *McLean*, 36 Fed. Rep., 213.

There is absolutely nothing in the cases cited by counsel for the Rubber Companies on this point which militates against our position.

In *Porter* v. *Pittsburg Bessemer Steel Co.*, 120 U. S., 649, the Supreme Court held *that as a matter of fact,* Crawford did not control the board of directors, and cited as evidence of this fact, *that the board of directors refused to ratify the contract which Crawford presented to them.*

So likewise in *Higgins* v. *Lansing*, 154 Ill., 355, the court

say that the directors "were voted in by a certain party, who "had no control over them after they were voted in."

Moreover, in the *Higgins* case, the persons who were charged with controlling the directorate, were not outside creditors, but were stockholders themselves, and simply exercised their rights and powers as stockholders to elect directors and the complainants likewise were not creditors, but merely co-stockholders.

Pullman Car Co. v. *Missouri Pacific Co.*, 115 U. S., 587, has no bearing on the facts of this case.

Kitchen v. *St. L., etc., Ry.*, 69 Mo., 224, is also in no respect in point. There was no contest there between creditors. The complainants were mere stockholders attempting to attack an arrangement which had been *openly* made, and acquiesced in for a long period of time.

V.

Having Assumed the Fiduciary Relation of Directors, the Burden is on the Rubber Companies to Show That They Acted in Good Faith.

Petitioners, at various stages in their brief, contend that being charged with fraud, the Respondents must, at the threshhold, establish that charge by direct and positive proof. We earnestly believe that we have more than done this. But we challenge the correctness of counsel's legal position.

We have shown (Division IV of this argument), that the Rubber Companies were directors to all intents and purposes, and thereby necessarily assumed the duties and responsibilities of that office. Mr. Justice HARLAN, in *Sutton Mfg. Co.* v. *Hutchinson*, 11 C. C. A., 320, discussed this proposition at some length, and held, that: "in cases "of that kind" (security given to directors), "a court of

"equity will closely scrutinize the transactions, and in a "contest between general creditors and a director or man- "aging officer who takes a mortgage upon the property, will "hold the latter to *clear proof that the mortgage was exe- "cuted in good faith, and was not a device to enable him to "obtain an advantage for himself over those interested in "the distribution of the mortgagor's property.*"

In the well-considered case of *Wilkinson* v. *Bauerle*, 41 N. J. Eq., 645, the Chancellor held that: "When directors "make sale of corporate property to one of their number, "who takes part in the transaction as both buyer and seller, "and creditors are thereby deprived of the opportunity to "enforce their debts, then it results from the relation * "* * existing between them and the creditors, *that it "devolves on the directors to show that the transaction was "made in good faith.* * * * If they fail to show these "facts, creditors are entitled to compel them to account for "the full value of the property."

It must be true that when a director, claiming to be a creditor, obtains an advantage, by way of preference, or otherwise, over other creditors and the transaction by which he obtains such preference is challenged, it becomes his duty in the first instance, to show that he acted in good faith, and the burden is upon him to do so.

This is only the application of a familiar rule which needs the citation of no authorities. Whenever an attorney, or solicitor deals with his client, and the transaction is afterwards challenged as fraudulent, or when a trustee deals with the beneficiary under the trust, or when any individual, or officer occupying a fiduciary relation, deals with the subject matter in his keeping, the law casts upon him the burden of showing that the transaction was *bona fide*, just and

equitable. We invoke this rule and respectfully insist that it applies to the Rubber Companies under the facts and circumstances of this case.

VI.

The Rubber Companies are Legally Responsible for and Chargeable with the Fraudulent Representations and Other Deceits Practiced by the Fargos after January 6, 1896.

The fraud perpetrated by the use of printed letter heads containing false statements as to the officers of the company is directly brought home to the Rubber Companies by the fact that these letter heads were used by the Fargos in their correspondence with the Rubber Companies themselves. (*Supra*, p. 30.)

Moreover, the evidence establishes a deliberate combination between the Fargos and the Rubber Companies to the end that the Fargos should be ostensibly held out to the world as occupying their former relation to the company, and any and all acts of each party in furtherance of such a conspiracy are directly chargeable to all the others.

So, too, the evidence establishes a combination between the parties to uphold the credit of the Fargo Company at all hazards. All agreed that the January scheme should be kept secret in any event. The judgment notes given to the Rubber Companies constituted one of the essential elements of this scheme, and all the parties knew that this item in the arrangement must be included in the general plan of secrecy. The Rubber Companies must have understood and expected that the Fargos were likely, indeed certain, to make statements to the commercial agencies and to individual creditors as a basis of new credit and to

procure extensions of old and new debts. They knew that one of the first questions asked would be, "Have you any "judgment notes out?" It must also have been understood and expected that the Fargos, when so interrogated, would conceal and even deny the existence of such notes. The very agreement for secrecy in itself afforded an opportunity and inducement, amounting almost to a demand, that false statements should be made. It is not surprising, therefore, that under such circumstances the Fargos should have made false representations as to their assets and liabilities, and the existence of the judgment notes. Speaking of a similar state of facts, the Supreme Court of Colorado (*Walton* v. *Bank*, 13 Colo., 265) well said:

"The effect of the combination was that no other creditor, "however diligent he might be, however honest or old his "claim might be, could have access to any of the property of "Howard P. Walton, to the detriment of E. T. Walton, and, "the evidence showing the existence of the confession of "judgment, the agreement to keep it from the public was, "in my opinion, sufficient to establish a confederation be-"tween the two which would admit the acts and declarations "of one against the other."

Accordingly the court held the creditor brother chargeable with the false representation of the debtor, saying:

"It is said by Mr. Justice WASHINGTON, in delivering the "opinion of the court in *Fur Co.* v. *United States*, 2 Pet., "365, that, 'where two or more persons are associated to-"gether for the same illegal purpose, any act or declaration "of one of the parties, in reference to the common object, "and forming a part of the *res gestae* may be given in evi-"dence against the others.'"

"Howard Walton, relying on his brother's agreement not "to make the confession of judgment public, could with "great assurance make the fraudulent representations to the "cashier of the bank that his brother had no security, and

"was not pressing him. Without such agreement he would "feel that judgment was likely to be entered against him "at any time, and this would have a tendency to restrain "him in his dealings with others * * * (p. 277.)

Walton v. *First Natl. Bank*, 13 Colo., 265.

But we need not indulge in argument on this subject. The record is not lacking in direct evidence that the Rubber Companies actively assisted the Fargos in their course of deceit and misrepresentation. We refer of course to the method adopted by Mr. Fargo in the middle of July to secure an extension from the Bank. Mr. Beale's own testimony on this subject is as follows (Rec., 561):

"I am under the impression that some time in the middle "of July he (Fargo) came in and told me that Mr. Keith "had told him to pay the note coming due at that time, and "he could not go to Mr. Keith and explain why he could not "pay it, because there would be some embarrassing ques- "tions asked, and finally it was decided by him, as I remem- "ber it, at that interview with him, but whether on my ad- "vice or not I am unable to say, that he would just put a "new note in a letter and write to Mr. Keith, in order to "have the entire information contained in the letter and not "have to answer any embarrassing questions. I think this "was done."

But the situation disclosed by this record makes out a much stronger case against the Rubber Companies than that under discussion in *Walton* v. *Bank, supra.* By the election of these dummy directors the Rubber Companies, in fact, secured absolute control of the corporate powers and volition of the Fargo Company, secretly and in bad faith, in order to effectuate their own secret and selfish ends. Having usurped these corporate powers, they immediately called the dummy directors together, and, on January 9th, caused them to re-elect Charles E. Fargo president and Frank M. Fargo

vice president of the Fargo Company for the ensuing year. (Rec., 65.)

By verbal understanding between the Fargos and Mr. Beale, Frank M. Fargo was to cease to be treasurer, but to "act" as treasurer. (Rec., 570.) THAT IS, HE WAS TO HOLD HIMSELF OUT TO THE WORLD AS THE TREASURER. This amounted to nothing less than the employment by the Rubber Companies of the Fargos, as their agents, to carry out a scheme the primal element of which was the preservation of the credit of the Fargo Company. Mr. Beale himself says: "*The three Fargos were to run the business, just as everybody knew they had previously run it.*" (Rec., 569.) Having thus launched their scheme, having affirmatively installed the Fargos as the ostensible heads of the company, having clothed them with unlimited powers, under an arrangement designed to preserve, at all hazards, a fictitious credit for the company, can it be questioned that the Rubber Companies are responsible, legally and equitably, for every act of the Fargos in utilizing these powers to effectuate such wrongful ends?

In the case of *Allen* v. *Bank of Commerce*, the Circuit Court of the District of Colorado, relying upon Judge Grosscup's first opinion in the case at bar (*U. S. Rubber Co.* v. *American Oak Leather Co.*, 77 Fed.,671) held that the Bank of Commerce was liable for false representations made by the Mercantile Company, a Colorado corporation. The case was appealed to the Circuit Court of Appeals for the 8th Circuit, and the decision of that court is found reported as *Bank of Commerce* v. *Allen*, 90 Fed., p. 545. The decree below was reversed, but the Court of Appeals in its opinion dwells at length upon the facts disclosed by the record in the *Allen* case, for the purpose of demonstrating that the facts were essentially unlike the facts in the case at bar as stated

in Judge Grosscup's opinion. The striking feature, say the court, wherein the two cases differed, consisted in the circumstance that in the *Allen* case the Mercantile Company was in control of its own board of directors, and not in fact under the power of the Bank of Commerce. Judge Thayer in effect says that if the Bank of Commerce had controlled the board of directors of the Mercantile Company, as the Rubber Companies controlled the Fargo board, the Denver bank would have been responsible for the false representations made by the president of the Mercantile Company.

The law is settled that every partner is personally responsible for false representations made by his copartners in the course of the partnership business. This rule is carried so far that an innocent partner may be sued for the deceit of his copartner, perpetrated without his knowledge, and be imprisoned upon a judgment so recovered in an action where imprisonment is permitted.

The best that can be said of the relations between the parties in this case is that the Rubber Companies became practically copartners of the Fargos in this fraudulent scheme, and in pursuance of this partnership, caused the dummy directors to clothe the Fargos with the power to make the false representations which they made to the American Oak Leather Co., to the Dixon banks, to the Pfister & Vogel Leather Company, to the Mercantile Agency, etc. (Statement of facts, *supra*, pp. 29-34.) The fraud of the Fargos in making such representations must be imputed to their partners or employers, the Rubber Companies. The Fargos being conclusively shown to have been guilty of gross fraud and deceit, the Rubber Companies must be held chargeable with the same fraud and deceit.

1 Bigelow on Fraud, 247.

Wolf v. *Pugh,* 101 Ind., 305, and numerous cases there cited.

Bennett v. *Judson,* 21 N. Y., 239.

Mechem on Agency, Sec. 739.

The false representations made by the Fargos to obtain credit after January, color and characterize the January scheme itself, and demonstrate that it was conceived in wrong and executed in fraud, and that the fraud in its execution, as well as the fraud in its conception, are directly chargeable to the Rubber Companies themselves.

In the case of *Blennerhassett* v. *Sherman,* 105 U. S., 118, the Supreme Court called attention to the false representations as to the mortgagor's credit, made by the mortgagee, during the time the mortgage was kept secret, and held that these false representations were sufficient in themselves to taint the whole transaction and all its elements with actual fraud.

So likewise in the case at bar the false representations made by the Rubber Companies through their partners and tools, the Fargos, are enough in themselves to convict the Rubber Companies of actual fraud throughout the whole transaction.

VII.

The Petitioners Contend that the Creditors of the Fargo Company as a "Class" or "Collectively," were in as Good, if not a Better Position after, than They Were Prior to the Launching of the January Scheme.

This contention is made at page 21 of Petitioners' brief. Its absurdity will at once be manifest by a consideration of the actual facts. In our statement of facts, pages 38-39 of this

brief, we have shown the fallacy of the Master's conclusion, that the indebtedness of the Fargo Company to what are called the "general creditors" (creditors other than the Rubber Companies and the Bank), was materially reduced during the period from January to August, 1896. The Master finds (Rec., 163) that on January 6, 1896, there was $210,216.20 owing to creditors other than the Rubber Companies, the Bank, and the creditors who held the notes of the Fargo Company upon which the Fargos themselves were guarantors, and from which they so dexterously escaped personal liability.

In his preliminary report dated May 29, 1896 (Rec., 136), the Master, who was and is likewise the Receiver, found that the claims actually filed with him as such Receiver, by creditors other than the Petitioners, amounted to $180,037.53. The claims of "general creditors" allowed by the final decree, amounted to $160,403.65, and this, in the teeth of the *Master's final report, finding that the indebtedness in August was only $142,000.* Here is a discrepancy of nearly $40,000 between the fact, and what the Master finds the fact to be. But this error of the Master is only another illustration of the many errors to be found in his final report, to which we have directed attention in our statement of facts.

This discrepancy between the final decree and the claims filed with the Master while acting as Receiver under the order of Court, is due to the fact that a large number of claimants failed to pay their *pro rata* assessment of the costs of this litigation, and were therefore, barred by the decree from sharing in the fund. (Rec., 136.) The claims actually filed with the Master in his capacity as Receiver amounted, as we have said, to $180,037.53. In a matter of this magnitude, where there are hundreds of creditors scattered

all over the country, it is fair to assume that a considerable number of claims existed which were not filed, either through ignorance, or indifference on the part of the claimants, or disinclination to join in the litigation and share in its risks, hazards and expense. This is not infrequent. In litigation of this character, creditors frequently stand by and permit a handful of fellow creditors to carry on the litigation at their own expense, and hope to share in the victory without incurring any of the risks or costs. In this very case the Master, acting as Receiver, in his report of April 28, 1897, mentions two claims aggregating $1,392.55, which he did not include in his list or report as Receiver, because they had come to him too late under the order of court. (Rec., 133.) To this aggregate must be added the claims for mechanics' liens on the Dixon plant, which were so large that the Bank abandoned the property for which it had paid $25,000 shortly prior thereto, rather than redeem from such liens. Under the circumstances, it is fair to fix these liens at $25,000.

Taking then, the claims actually filed, the mechanics' liens on the Dixon property, and said two claims which came too late ($1,392.55), *we have a total of the "general indebtedness" on August, 6, 1896, of $206,430.08*, instead of $142,000, as found by the Master in his final report; a discrepancy of $64,430.08. Now add to said $206,430.08 a reasonable percentage of claims not filed for the reasons hereinbefore stated, and we show to a demonstration, that the *indebtedness of the Fargo Company when the final collapse came in August, exceeded the indebtedness of the company when the January scheme was conceived and brought into life.*

And even if the facts were as claimed by Petitioners, it

is difficult to understand how our clients would have been in any way benefited.

Take the case of the American Oak Leather Company, whose claim was increased from $3,500, when the January scheme was created, to over $12,000 in August. Take the case of the Pfister & Vogel Co., Wilder & Co., and the Eagle Tanning Works, likewise judgment creditors and Respondents here. The Master finds that the claim of the Pfister & Vogel Co. was $17,557.90; the claim of Wilder & Co. $4,584.95; and the claim of the Eagle Tanning Works $2,500.24, and that all three claims were wholly created after the January scheme was put into full operation. (Rec., 165.) Neither the American Oak Leather Company, Pfister & Vogel Co., Wilder & Co., or Eagle Tanning Works, had ever in any prior year given credit to the Fargo Company for more than one-third of the credit given after the January scheme was launched.

Take the claim of the two Dixon banks amounting to $17,000. The money was borrowed in February, 1896, by means of the grossest fraud and deception perpetrated by Frank M. Fargo, who was then falsely held out by the Rubber Companies as the actual treasurer of the Fargo Company. Prior to this time the Dixon Banks had never loaned the Fargo Company a single dollar. (Rec., 303-305, 316.)

In passing, it is proper to remark that Mr. Beale earnestly urged Fargo to borrow no more money from the Metropolitan Bank, on the ground that if he did so, *the Bank might justly claim that under the January scheme, it had been deceived.* (Rec., 563-4, and *supra*, p. 55.) But the Rubber Companies and their counsel seem to think it per-

fectly proper for the Fargos to borrow $17,000 from the Dixon banks by means of shockingly false representations, and not a word of condemnation for this conduct do we find in opposing counsel's brief. On the contrary, they ask this court to believe that the Fargos are honest men.

We respectfully ask the court, is the situation of the foregoing creditors in any way improved, or can their equities be in any way affected by the results to some other creditor, or to the creditors "as a class," taken "collectively?" The six Respondents hereinbefore named, pray this court to consider their situation, and the losses they have sustained, by the wrongful conduct of the Petitioners. The best that can be said for the Petitioners on their own theory, is that they were fraudulently experimenting with the property of the "general creditors."

The fact that neither the Rubber Companies, nor the Bank gave a dollar of credit to the Fargo Company after the January scheme, in our judgment, is one of the most striking features in the case. Beyond the purchase price of $50,000 loaned (in the form of the Candee Co. plain notes) to secure the fraudulent preferences, not a dollar was advanced, or intended to be advanced to the Fargo Company to save it from *going to the wall.* On the contrary, it was expressly provided by the January scheme that either this $50,000 advanced in notes, or the $44,900 due the Candee Company must be paid at all hazards as the notes matured. *As a direct result, substantially every dollar advanced by the Rubber Companies in January had been returned to them by the following May;* returned under conditions which the Rubber Companies must have known were depleting the treasury of the Fargo Company, and would make it impossible for the Company to continue in business.

If there were nothing else in this record showing that this pretended loan of $50,000 was not made in good faith, and was not made to help the Fargo Company tide over its "temporary embarrassments," Fargo's letter to Sadler shows how utterly impossible it must have been for the Fargo Company to pay back said loan of $50,000 in four months, and at the same time continue its business, with the slightest hope of pulling through. That letter is as follows (Rec., 581):

"CHICAGO, April 27, 1896.

"*Mr. H. M. Sadler:*

"** * * The receipts this month which are one-third "less than our calculations, and 40 per cent. less than in "the same time last year; this is likely to continue * * "* This, of course, contemplates the payment in cash as "fast as collected for present and future sales. We have "now paid about $40,000 of your notes just matured, and "have $5,000 to pay next month, which shall be paid out-"side foregoing. We are pushing hard on old accounts. "but they come in very slowly. * * **

"C. H. FARGO & Co.
"By Charles E. Fargo."

A business house whose current indebtedness is over $400,000 as was that of the Fargo Company in April, with assets considerably less, and whose receipts are "*one-third less than its calculations,*" and "*40 per cent. less than in the same time last year,*" can not, without extraordinary help, hope to pull through. Johnson and Sadler, astute and experienced business men, representing one of the great industrial combinations of this country, must have known this to be literally true. In the preceding January, the Fargo Company was so hard pressed, and its assets so unavailable for the payment of current obligations, that if $10,000 had not been advanced on January 6, according to the admis-

sion of all parties to this litigation, it would have been compelled to close its doors. Notwithstanding this terrible pressure and the great reduction in collections and receipts, the Rubber Companies were relentless in their demands that their claims should be paid, while the demands of other creditors were in every possible instance postponed and extended. (Rec., 582.)

Within a period of four months, the Rubber Companies got back $45,000, as shown by said letter. Had the Rubber Companies been the most aggressive of creditors, instead of helping the Fargo Company tide over its "temporary embarrassments," as they now pretend they were doing, they could not have been more persistent and grasping in collecting their demands.

In the light of these facts, how is it possible for this court to ever find that the Rubber Companies loaned their credit to the extent of $50,000 in January for the purpose of helping the Fargo Company over its "temporary embarrassments," when the record shows, without dispute or controversy, that they were forcing the Fargo Company to pay, with a rigor which could not have been exceeded by the most unfriendly creditor.

VIII.

As to the Effect of the Master's Report.

Counsel suggest at page 14 of their brief, that the Master's findings should be accepted as presumptively correct, and not be set aside unless clearly wrong, on the ground that the cause was referred to the Master to take proofs and report the same together "with his conclusions thereon as to the "facts only."

In support of this contention counsel cited in the court

below, *Bosworth* v. *Hook*, 77 Fed. Rep., 686, and *Boesch* v. *Graff*, 133 U. S., 705, but have abandoned these authorities and now cite *Crawford* v. *Neal*, 144 U. S., 585, and *Davis* v. *Schwartz*, 155 U. S., 631.

In the *Bosworth* case, the proceeding there under review, was an intervening petition filed against a receiver. On the latter's motion the Circuit Court had "ordered a refer- "ence to a Master to hear evidence and report the same to "the court with his conclusions thereon." The Master reported *adversely to the receiver*, who filed exceptions *which the Circuit Court overruled*, and entered judgment in favor of the petitioner. In disposing of the case, the court said:

"There is, therefore, no ground upon which she (the pe- "titioner) can have a demand against the receiver, or against "cars or other property of the railway company in his pos- "session.

"In reaching this conclusion, which we deem it sufficient "to announce, without going into the details of evidence, "we have not been unmindful of the rule, often stated and "reiterated, that the findings of a Master, concurred in by "the court to which they were reported, are presumptively "correct and will be permitted to stand, unless obvious error "of law or important mistake of fact has intervened. *Fur- "rer* v. *Ferris*, 145 U. S., 132; 12 Sup. Ct., 821; *Crawford* "v. *Neal*, 144 U. S., 585; 12 Sup. Ct., 759; *Walker* v. *Kin- "nare*, 76 Fed., 101. *When, as in this case, the reference "was made upon motion of one of the parties and not by "agreement of both, the Master's finding has not the force "of a verdict, or of the report of a referee, and, on excep- "tions thereto, the court must determine by its own judg- "ment the controversy presented (Kimberly* v. *Arms*, 129 "U. S., 512; 9 Sup. Ct., 355); *and, on appeal, the court of "review, of course, has the same power and responsibility.*

"*The decree of the Circuit Court is reversed, with direc- "tion to dismiss the petition.*"

So in *Boesch* v. *Graff*, 133 U. S., 705, the Supreme Court, by Mr. Chief Justice FULLER, said:

"*The report of a Master is merely advisory to the court,* "*which it may accept and act upon in whole or in part, ac-* "*cording to its own judgment* as to the weight of the evi- "dence. *Kimberly* v. *Arms*, 129 U. S., 512, 523. Yet, in "dealing with exceptions to such reports, 'the conclusions "of the Master, *depending upon the weighing of conflicting* "*testimony*, have every reasonable presumption in their "favor, and are not to be set aside or modified unless there "clearly appears to have been error or mistake on his part.' "*Tilghman* v. *Proctor*, 125 U. S., 136, 149. We think there "was error here within that rule."

Boesch v. *Graff*, 133 U. S., 705.

Upon examination of *Crawford* v. *Neal*, 144 U. S., 585, the court will find that it was a hotly contested case, where there was a great volume of testimony taken, and where an irreconcilable conflict existed in the testimony. It may be true that in such a case it is wise for the court to indulge in the presumption that the conclusions of the Master, before whom the witnesses appeared, and who stood "in the midst of the storm" while the testimony was being taken, ought, in the first instance to be taken as presumptively correct, unless some obvious error has intervened, etc.

As we have already said, there was absolutely "*no conflicting testimony*" to be weighed by the Master in the case at bar, and therefore, the reason of the rule that "every reasonable presumption in favor of the "Master's conclusions shall be indulged in," does not exist, and has no application here. In short, the conclusions of the Master in this case are substantially nothing but the simple statements of the witnesses themselves, culled out and put in historical order for the convenience of the court.

The Master was not called upon at any stage to weigh conflicting testimony, or conflicting facts, because none existed.

The court will remember that the history of the January scheme and the collapse of the Fargo Company is found solely in the testimony of the Petitioners and their representatives, who certainly may be presumed to have given the subject the best possible coloring.

IX.

The Metropolitan National Bank Ratified and Shared in the January Scheme when the Collapse came in August, and then and there Deliberately Helped the Fargos as Officers and Directors of the Fargo Company to Loot its Treasury to the Extent of at least $10,000.

There are three propositions to be considered with respect to the rights and responsibilities of the Bank in this case:

1. The Bank knowingly adopted, ratified and assisted in consummating the January scheme, and thereby became chargeable with all the fraud of the Rubber Companies. On this proposition all the Judges who have considered this case, namely: Judge Grosscup of the Circuit Court, Judges Woods, Jenkins and Showalter (deceased), of the Court of Appeals, and Mr. Justice Brown of this court, are agreed. Mr. Justice Brown and Judge Grosscup held that the Rubber Companies and the Bank were guilty of constructive fraud, and Judges Woods and Jenkins held that they were guilty of actual fraud. In the opinion of the Circuit Court of Appeals in the first appeal (82 Fed. Rep., 248), the court held it was not necessary then to determine whether there was, or was not actual fraud, and therefore, the record does not show Judge Showalter's judgment on the question of actual fraud.

2. The advance of $10,000 was made with the knowledge that the corporation was then failing, that the money was to be used for the sole personal benefit of the Fargos, and was being paid as a price to induce its officers to give the Bank a security to be used against the other creditors; this tainted the entire transaction and made it actually corrupt and fraudulent.

3. The cancellation of one of the $25,000 judgment notes in consideration of the transfer of the Dixon plant, was not procured by any fraud or misrepresentation on the part of the Fargo Company, but was done by the Bank advisedly and in fact, at its solicitation. The debt having been actually discharged as between the parties, the Bank could not—even in a contest between it and the Fargo Company—enforce that part of its claim; therefore the Bank can not enforce as against complainant and the intervening petitioners (Respondents here) a claim which could not be enforced against the Fargo Company itself.

WHAT WAS THE EFFECT OF THE PAYMENT OF THE $10,000 TO THE FARGOS?

Of the main facts with reference to the purpose for which this $10,000 was paid, there is no dispute whatever; the effort on the part of the defense being merely to palliate in some way, the bare-faced fraud, which Fargo's testimony showed had been committed.

Fargo testified that he told Mr. Keith that his company was about to fail, that he and his brothers needed money to live upon, and that if the Bank would advance $10,000 for that purpose, Fargo would give the company's judgment notes for this and the $40,000 already owing the Bank, making $50,000 in all, and put them on an equality with the Rubber Companies. (Rec., 191-2, 195-6.)

Cross examination by the counsel for the Rubber Companies failed to produce any substantial change in this testimony: on the contrary it was reiterated. (Rec., 265.) Whatever else may be said of Mr. Fargo in this case, it certainly can not be charged that he is unduly favorable to Respondents, or interested in warping his testimony in the slightest degree to assist them.

On the part of the defendants the only attempt at controverting these facts was by having Mr. Keith deny that Fargo told him he wished the money to live upon. But Mr. Keith's version of the interview showed that he was told that the money was to be used for the personal benefit of the Fargos, by taking up their individual notes secured by a pledge of their individual collateral; Fargo telling him that the money raised on those notes had been in some way put into the business. (Rec., 389.) No attempt was made to prove an actual indebtedness from the company to any one of the Fargos, except by asking Chas. E. Fargo, on cross-examination, the general question whether it was true that the company owed him and his brothers $10,000. (Rec., 265.) Nothing was shown as to when the money was advanced by them to the company, which one advanced it, for what purpose it was used, or anything with reference to the transaction in any way, not even a statement that the money had not been repaid to them. The entire matter was left upon the mere statement of Fargo's conclusion, that the company was indebted to him and his brothers in some amount exceeding $10,000.

It obviously makes no difference in the result, that the Fargos intended to use this money to take up individual notes secured by their individual collateral. That was but the method by which they sought to use it for their personal ends. The harm was done when they received the money.

When they had paid those notes it would give them back their bank stock, which was of more value than the amount of the notes, and thus give them a still greater advantage than would result from merely keeping the money. But the effect upon the situation, and upon the rights of the creditors of the corporation, was precisely the same.

We have it, then, conceded that the Bank advanced this money for the purpose of personally benefiting the Fargos at the expense of the creditors of the corporation; that it had no information of the existence of any debt from the company to the Fargos except what it got from Fargo himself, who was concededly acting in his own interest and could not bind the corporation by his admissions. Without any further inquiry, the Bank paid him the money; and that inquiry would not have developed anything beneficial to the defense in this case, is clearly shown from the fact that no competent evidence of the existence of the debt was offered on the hearing.

The claim that the money was paid to the company at all is a mere pretense, having no other basis or color of truth than arises from the bare fact that Fargo was president. He never paid it over to the company; he simply handed over the company's note and kept the money himself, just as Mr. Keith knew he intended to do. When objection was made, on the hearing to his statement that the corporation received and paid out the money, as calling for his conclusion, and he was asked to state what was actually done with the money, he answered as follows, the questions quoted being put to him by Mr. Beale:

"Q. What was actually done with the money? A. The "money was divided between my brothers and myself fin-"ally.

"Q. By the corporation? A. By the corporation.

"Q. For what reason? A. Because the corporation "owed it to us; because we had to have some money to live "on and the corporation owed it to us.

"Mr. Newman: You do not mean the corporation owed "you a living?

"The Witness: No; *I do not mean to put it that way.*

"Q. (By Mr. Beale.) On what ground did the corpora- "tion owe you the money? A. For money actually "loaned it.

"Q. *Have* you and your brothers loaned them as much "as $10,000? A. Yes; more than twice as much." (Rec., 265.)

We have quoted this at length, because it is the only attempt at proof of the actual existence of an indebtedness from the corporation to the Fargo brothers. And the court will at once notice that it is limited to a bare statement that the total advances made to the company exceeded $10,000, with no information as to what payments had been made, or what balance, if any, remained unpaid. The transaction was—to put it very mildly—suspicious to the last degree, and called loudly for explanation. The facts were—on the theory of good faith—susceptible of statement with mathematical precision; the witness who knew all about them was on the stand and being cross-examined by the side, and by the counsel, to which he was friendly and with which his interests were allied. Under these circumstances, the industrious failure to put in evidence any of the actual facts with reference to this alleged debt is strikingly significant.

If the Fargos, one or all, were now suing the company to recover this indebtedness, would the court, on this evidence, enter judgment in their favor? Clearly not.

We have characterized the claim that the $10,000 advanced by the Bank was paid to the Fargo Company and by it divided among the brothers as a mere pretense; but in

view of all the facts of this case it was worse than that. The pertinent question at once presents itself, who acted for the corporation? The money is conceded to have been paid by the Bank to Charles E. Fargo, and there is no statement in the evidence that any other officer represented the company in either receiving or disbursing the money. It is a plain proposition that he could not be both principal on one side and agent on the other, that he could not bind the corporation in a transaction with himself and for his personal benefit. For him to try to do so would of itself be a fraud.

And if we take his answer to the suggestive question of defendant's counsel, that the money was divided among the brothers "by the corporation," as meaning or proving, that the other ordinary corporate agencies participated in the transaction, so that it was in fact the act of the corporation and binding on it, the fraud becomes at once more glaringly apparent and far reaching in its consequences. Who and what were the other corporate agencies, the treasurer and secretary of the corporation, and its board of directors? The treasurer and secretary was Mr. Buell McKeever, a clerk in the employ of the Rubber Companies' counsel, who was elected with the understanding that he should perform none of the duties of his office. Did Frank Fargo, who was still falsely held out to the world as treasurer, bind the corporation by putting its funds in his pocket? If, so, there is no such thing as embezzlement. Clearly if the corporation was bound by this transaction, so that the receipt and disbursement of the $10,000 was a corporate act—we use the singular number with grammatical propriety—it was because the board of directors sanctioned it. That board was the mere instrument of the Rubber Companies, knowing no will or interest but theirs, and its members were bound to them by the relation of attorney and client. On the theory

that the money was received by the corporation, there is nothing to save its division among the Fargo brothers from being a barefaced looting of the corporate treasury but the claim that the directors sanctioned it. The responsibility for it thus rests directly upon the Rubber Companies. They and those who, through the exercise of the corporate functions of Fargo & Co., were seeking to accomplish their ends, issued the judgment notes by which alone was the money obtained, and either authorized or connived at its flagrant misuse. Mr. Porter, who was, in Mr. Beale's absence, acting as the chief counsel for the Rubber Companies at the time of the failure, both in entering the judgments, preparing the assignment of the accounts, and as a member of the board of directors of the Fargo Company, framing and passing the necessary resolutions, admits that he knew of Fargo's procuring the $10,000; that it was included in the judgment which he consented should share on an equality with those of the Rubber Companies, and so far from preventing it, says he did not even disapprove of it. (Rec., pp. 449, 450.)

As part and parcel of the arrangement under which this money was thus advanced to the Fargos, the judgment notes given and the property seized under them, the contract was executed between the Bank and the Rubber Companies, by which they agreed to *pro rata* all collections which either should make. By this agreement they bound themselves "to "*unite their efforts to collect their respective claims against* "*said company, and share pro rata in the results thereof.*" (Rec., p. 385.)

Here again, the Rubber Companies took upon themselves the responsibility of enforcing the collection of this $10,000 against the rights of the other creditors. And not only did they agree to assist in enforcing it, but, if the bank was unable to collect it, to share *pro rata* all that they collected

on their own judgments and from the accounts. In effect, though the Bank advanced the $10,000 in the first instance, the Rubber Companies thus agreed to contribute their share of whatever part of it was not collected out of the assets of the insolvent concern. What was the meaning and the object of this close and formal offensive and defensive alliance? Plainly they foresaw that in the litigation which the defrauded creditors were sure to institute, one of their claims, or a part of it, might be thrown out as fraudulent, and they wished both to secure mutual loyalty, and to provide that the loss resulting from that probable contingency should be borne by all who were interested in the common enterprise. It was an agreement by which each traded a share in his own fraud for a share in whatever redeeming element might be found in the conduct of the other. We submit that this $10,000 transaction can not, without an abdication of intelligent judgment, be regarded as anything but a payment from the Bank and the Rubber Companies directly to the Fargos for their personal benefit.

But if, blinding our eyes to the real facts, we look upon the money as paid to the corporation, then the distribution of it to the Fargos was equally fraudulent, even if it were shown that they had a just claim against the company.

It is a fundamental principle of equity that the officers and directors of a corporation hold its assets, and their power over its corporate actions, in trust for its creditors. From this principle arises the rule that they cannot so use their power over its assets to secure a benefit to themselves at the expense of the creditors for whom they are trustees. Hence upon the insolvency of a corporation the officers and directors cannot so use its assets as to prefer themselves over other creditors.

This rule was enforced by the Court of Appeals (7th Circuit) in the case of *Sutton Mfg. Co.* v. *Hutchinson*, 11 C. C. A., 320, in which the opinion was delivered by Mr. Justice Harlan.

In that case an insolvent corporation at the time of its failure, gave a mortgage to secure a debt to another corporation. The officers and directors of the two corporations were substantially identical, and forty per cent. of the stock of the mortgagee was held by two of the directors of the mortgagor. After speaking of the distinction between the right of preference on the part of an individual and a corporation, and the distinction between the mere security by a corporation to a director made in the ordinary course of business, and one made in contemplation of failure, Mr. Justice Harlan says:

"The contention of the defendants is that in disposing "of their respective properties an individual and a corpora- "tion were recognized at common law as having equal rights; "and as the former may, in the absence of a statute forbid- "ding it, transfer the whole or part of his property with the "intention or with the effect of giving a preference to some "of his creditors to the exclusion of others, so an insolvent "corporation when financially embarrassed and not intend- "ing to continue its business, may make a preference among "its creditors, whoever they may be, and whatever their rela- "tion to the corporation or to the property transferred. If "this be a sound rule, it would follow, that directors, being "also creditors, of an insolvent corporation, which has aban- "doned the objects of its creation and ceased an active ex- "istence, may distribute among themselves its entire assets, "if the reasonable value thereof does not exceed their aggre- "gate demands. We cannot accept this view. In our judg- "ment, when a corporation becomes insolvent and intends "not to prosecute its business, or does not expect to make "further effort to accomplish the object of its creation, its

"managing officers or directors come under a duty to dis-
"tribute its property or its proceeds ratably among all
"creditors, having regard, of course, to valid liens or charges
"previously placed upon it. Their duty is 'to act up to the
"end or design' for which the corporation was created (1
"Bl. Comm., 480) and when they can no longer do so their
"function is to hold or distribute the property in their hands
"for the equal benefit of those entitled to it. Because of
"the existence of this duty in respect to a common fund in
"their hands, to be administered, the law will not permit
"them, although creditors, to obtain any peculiar advantage
"for themselves to the prejudice of other creditors. This
"rule is imperatively demanded by the principle that one
"who has the possession and control of property for the
"benefit of others—and surely an insolvent corporation
"which has ceased to do business, holds its property for the
"benefit of creditors—may not dispose of it for his own
"special advantage to the injury of any of those for whom
"it is held. That principle pervades the entire law regulat-
"ing the conduct of those who hold fiduciary relations to
"others, and, instead of being relaxed, should be rigidly
"enforced in cases of breach of duty or trust by corporate
"managers seeking to enrich themselves at the expense of
"those who have an interest equally with themselves in the
"property committed by law to their control. It would be
"difficult to overstate the mischievous results of a contrary
"rule, as applied to those intrusted with the management
"of corporate property."

There can be no doubt that this principle applies to the case at bar, and that this preference of the claim of the Fargos—even if we were to concede that they had a *bona fide* claim—was a fraud in which the Bank and the Rubber Companies knowingly united and gave their active assistance. *If the Fargos had taken a judgment note for their claim, they never could have enforced it against the rights of the other creditors, even if the judgments of the Bank and the Rubber Companies were valid.* Their only way of

"getting something to live on" was by having the cash in hand. The money paid in order to thus make effectual from the start the perpetration of this fraud on creditors, cannot be regarded as having the first element of a just claim. On the contrary, the fraud which was its dominating element infects the whole transaction. It is no part of the business of a court of equity to separate the good from the bad in this mixture and consolidation of claims which was brought about as a part of a scheme of fraud.

The case of *Sutton Mfg. Co.* v. *Hutchinson, supra*, is cited in the brief of counsel for the Rubber Companies, where they seek to distinguish between preferences to directors and preferences to outside creditors. They admit the rule as we state it with reference to preferences to directors, and say also that in such cases the state decisions control in the Federal Court. Their reference to this principle and to the state decisions is in connection with their argument that an insolvent corporation has a right to prefer outside creditors, and that therefore the preference to the Rubber Companies is valid. This, of course, entirely ignores the obvious fact that the Rubber Companies controlled the board of directors, a fact which was so potent in its legal consequences in the minds of Mr. Beale and Mr. Porter that they did not dare to let that board pass the resolutions authorizing the judgment notes, because they thought the preferences would then be fraudulent within this rule. (Rec., 446-7.) But it was that board which authorized the transfer of the Dixon property to the Bank, and the judgment notes for $50,000, which included this $10,000 for the Fargos; and as a part of the same transaction, by contract prepared by Mr. Porter—who also prepared the resolutions—the Rubber Companies were given an interest in that property and in that judgment; and the property was,

by the terms of the pro-rating agreement between the Bank and the Rubber Companies, to be "subject to the care, "*custody*, control, management, *manipulation* and sale by "the firm of Isham, Lincoln & Beale, *who will act as trustees* "*in the premises for all parties concerned, and whose actions* "*and judgment in and about the same shall be sole, final* "*and conclusive.*" (Rec., p. 386.)

All of these papers were executed at the same time and as parts of one transaction, and clearly must be construed together. Their practical effect was undeniably to give to the Rubber Companies, through the direct action of their directors, an interest in the preference to the Bank, and to consolidate all of the claims of these three preferred creditors. This included, to the knowledge of the Rubber Companies and with their assent and active assistance, this $10,000 for the Fargos, the fraudulent character of which cannot be cloaked by explanation, and is rendered only more glaring by denial.

CONSIDERATION OF THE RULE LAID DOWN IN THE ATWATER CASE BY THE SUPREME COURT OF ILLINOIS WITH RESPECT TO THE RIGHT OF DIRECTORS OF AN INSOLVENT AND FAILING CORPORATION TO PREFER THEMSELVES.

It being conceded by opposing counsel that this court should follow the Illinois rule with reference to preferences by insolvent corporations. (Petitioner's brief, p. 24), we call attention to the leading Illinois case on that subject, which, with diplomatic tact, counsel failed to cite in their brief in the Court of Appeals and to which they have hardly, in their brief in this court, "paid the respect of a passing glance"—the case of *Atwater* v. *American Bank*, 152 Ill., 603.

In that case a preference by way of judgment note was given to Atwater for a *bona fide* debt due him, but it included also money due to two of the directors, Spaulding and Whittle. The preference was attacked as being fraudulent under this rule, and in defense it was urged that it was partly for a debt to an outside creditor, and therefore not fraudulent, at least as to that part. But the court held that the fraud infected and rendered void, as against creditors, the entire judgment. We quote from the opinion:

"Potter, Spaulding and Whittle were a majority of the "board of directors who authorized the execution of the "note to Atwater. Potter had an interest in consenting to "the making of that note, because he was thereby released "from his liability as guarantor, and Spaulding and Whittle "sought to obtain an unlawful preference by the use of At- "water's name. Atwater, who was himself a stockholder as "well as a creditor, permitted his name to be used by these "directors, *one of whom was his confidential agent and "friend*, as a cover for the purpose of obtaining for them "and for himself a fraudulent preference. A court of equity "can not allow him to reap advantage from such a trans- "action."

The court then takes up the question whether the fraud infected the whole judgment, and said:

"Where such a judgment is entered up as a fraudulent "cover to protect the defendant's property from his other "creditors, *or to put it into the hands of creditors who have "no right to appropriate it to their own debts*, courts will "deal with it as they would deal with any other fraudulent "contrivance. If a creditor permits a judgment—rendered "in his name for a large amount due to parties who have "no right to the entry of such judgment in their favor— "to be used for a fraudulent purpose as against subsequent "creditors, *he will be postponed until after they are paid*, "even though a portion of the debt embraced in the judg- "ment is honestly due to him. (*Citing cases.*) Atwater's

"debt was so blended with that of Spaulding and Whittle, "the directors, and his dealings with the corporation were "so far the dealings of Spaulding, that he must be held to "occupy no better position than they do: his rights and "theirs, we must presume, were voluntarily on his part put "upon the same footing."

No substantial distinction, in any way favorable to the defendants, can be pointed out between that case and this. In fact here the situation is far worse. For in the *Atwater* case the debts to the directors were in fact owing. But here there is no satisfactory evidence of any actual indebtedness from the company to the Fargos; and the circumstances under which the money was paid convince the mind that it was merely a means of keeping them friendly in the impending contest with other creditors, by furnishing them from the goods out of which those creditors had been defrauded, with money to live on.

That this $10,000 transaction places the Bank in an entirely different situation from what it otherwise would have occupied can not be seriously doubted. When Fargo applied to Mr. Keith for the money, telling him that the corporation was about to fail, the Bank could have stood upon and enforced its rights as a creditor, for the $40,000 which was actually owing. Its position as a creditor gave it the right to defeat—as all the courts who have considered this case have held the merchandise creditors have a right to defeat—the preferences of the Rubber Companies. By enforcing those rights it would have been in a position to share *pro rata* with the other *bona fide* creditors of the corporation.

But the Bank was not willing to rest upon the rights which its position as a creditor secured to it, because the enforcement of those rights would necessarily make it share *pro rata* with the other creditors. It desired to gain a preference over

other creditors, and to *prevent* them from enforcing their rights. For this purpose, it abandoned the side of the *bona fide* creditors, joined forces with the Rubber Companies, and agreed to assist them in their effort to defeat the other creditors. It was not content with doing this merely for the purpose of collecting the debt which was then owing, and which had been contracted without any fraud on its part, or connivance at the fraud of the Fargos and the Rubber Companies. It voluntarily added this $10,000 to its debt, and for no other purpose than to get an advantage over the other creditors, which could be secured only by assisting in the full accomplishment of the Rubber Companies' fraudulent scheme, knowing that the Fargo Company got no benefit from the transaction, and that the money was going for the personal benefit of those who were implicated in the fraud to which the Bank thus made itself a party.

Conceding that the Bank would have had the right, at the time of the failure, to take a judgment note or other security for its debt of $40,000, and to enforce the security for its individual benefit, if done without combination with the Rubber Companies, we submit that if it had such right, it was only because it was at that time a *bona fide* creditor, with no responsibility for the frauds which the Fargos and the Rubber Companies had committed. But on no theory can it justly be said that the Bank had the right—with full knowledge of all the facts placed before it—to enter into a new arrangement with the Fargos and the Rubber Companies, an arrangement which secured to it the advantages and benefit of the January machinery and which bound it to actively assist the Rubber Companies in the enforcement of their fraudulent scheme.

The affidavit of Mr. Keith on this subject, in the light of the subsequent evidence drawn from both him and Fargo

on the witness stand, was—to put it very mildly—utterly inexcusable. He not only makes no reference whatever to even the fact as he conceded it—that Fargo asked for this money to pay the individual notes of himself and his brothers—but he states—almost in so many words—*that he paid the money to the company with the understanding on his part that it was perfectly solvent, and had no intention of failing.* (Rec., 112, 113, 659-661.) This affidavit was omitted by the Bank and the Rubber Companies from the transcript on their appeal to the Court of Appeals, and we were compelled to file a supplemental record in order to bring it to the attention of that court.

In this affidavit Mr. Keith said that about the first of August, he notified Fargo that he would be unable to give the company further credit, and that the Bank's entire debt of $40,000 must be paid by the first of November following; that in response to this notice, Mr. Fargo called on him and stated that, owing to the difficulty of making collections, etc., the company would not be able to pay the Bank's debt at the date named, and that it would be obliged to borrow from the Bank $10,000 more; that Fargo at the same time said that the company was amply solvent, and there was no question that its assets would, in any event, be sufficient to pay off all its outstanding debts; that thereupon he agreed to advance the $10,000, if judgment notes were given for the entire $50,000; that Fargo assented to this, and told him that the Rubber Companies had judgment notes, and that he would get the necessary authority from his company to give the judgment notes requested by the Bank; that Fargo later reported to him that he had obtained the authority, and thereupon the Bank loaned Fargo & Co the additional $10,000 and received its two judgment notes for $25,000 each, and upon receipt of them, paid over to C. E. Fargo,

as president, $10,000 and surrendered to him the plain notes evidencing the other $40,000.

He then states that, having learned the extent of the indebtedness to the Rubber Companies, and that they had an agreement by which they were authorized to secure their debts before any of the other creditors, he investigated the agreement between them and Fargo & Co., and thereupon "caused further steps to be taken, looking toward the pay-"ment or security of the two judgment notes aforesaid, and "upon receiving a proposition from C. H. Fargo & Co. to "purchase its manufacturing plant at Dixon for $25,000 "he took said suggestion under consideration with a view "of determining the desirability thereof to said Bank." That he accepted this proposition, received the deeds to the property and cancelled and surrendered one of the $25,000 judgment notes. (Rec., 660, 661.)

The court will notice that in this affidavit Mr. Keith purports to state the order in which the transactions took place; *that he states them as successive and not concurrent transactions, and states absolutely that he paid over the $10,000 and received the two notes of $25,000 each before he entered upon the transaction for the purchase of the real estate at Dixon. Yet the undisputed fact is that the $10,000 was not paid over until the judgment notes were executed, and that the resolutions for the execution of the judgment notes and for the conveyance of the Dixon property in satisfaction of one of those notes were passed at the same meeting, in the afternoon of August 5th.* (Rec., 66-7.) FARGO SAID THAT HE WAS LOOKING OUT FOR THAT $10,000 AND DID NOT DELIVER THE PAPERS TO THE BANK UNTIL HE GOT IT. (Rec., 199-200.)

We contend then:

1. That the advancing of this $10,000 to the Fargos, and

including same in the judgment notes, was an active, actual fraud which infects the Bank's entire claim and renders it fraudulent as to the other creditors.

2. That the Rubber Companies actively participated in consummating the fraud, and have so blended the entire claim with theirs that the fraud taints their claims as well as the Bank's

3. That the Bank forever cancelled one of its $25,000 judgment notes, and satisfied the indebtedness it represented, by receiving in payment thereof the conveyance of the Dixon plant. That this part of the Bank's debt was cancelled and paid is shown by Petitioners admission at page 50 of their brief.

X.

The Decree of the Circuit Court of Appeals Holding that the Rubber Companies and the Bank Should be Postponed until the Claims of all other Creditors Have been Paid in Full, is Correct and Should Be Affirmed.

There are two plain and well established equitable principles upon which we base our contention that the order, or decree of the Court of Appeals should be affirmed and the decree entered by Judge Grosscup in the trial court should be modified so as to provide that the claims of the Respondents and other creditors who have proved up before the Master, should be paid in full before either the Rubber Companies or the Bank are permitted to receive any portion of the proceeds of the Fargo assets now in the hands of the Receiver for distribution.

First. The January scheme, and all things done and agreed to be done thereunder, pursuant to the secret under-

standing, are permeated with actual fraud, which in equity forbids the wrongdoers from sharing in the proceeds of the estate until the other creditors are paid in full.

Second. By this scheme the Rubber Companies clothed the Fargo Company with a false credit, and thereby induced the complainant and intervening petitioners to loan the Company money and sell it goods on credit, which they would not have done had they known the truth. By reason of this conduct the Rubber Companies deceived the other creditors into parting with their money and their property, for which they will never be paid, unless paid out of the fund in litigation. Justice and equity demand that these injured creditors should be repaid before the parties responsible for this condition of things are permitted to share in the fund.

The confession made by Fargo to Johnson, Sadler and Beale at the first Auditorium interview on January 2d, was that if they did not at once bolster up the Fargo Company it must immediately go to the wall. If the January scheme had not been then and there evolved and the Fargo Company had then ceased doing business, it could, and would thereafter have obtained no property or money on credit. The plan then adopted kept the Fargo Company alive with false credit and dug the baited pit into which subsequent creditors fell. Hence it follows that all credit given after January was the direct and necessary result of the Rubber Companies' conduct. The only way, therefore, that the creditors complaining here can receive full justice and protection is for this court to hold, as the Court of Appeals has already held, that their claims shall be paid in full before the Rubber Companies and the Bank are allowed to share in the estate.

Moreover, the moneys now in the hands of the Receiver were made up substantially of the proceeds arising from

merchandise which these "*drawn-in*" creditors were induced to sell. In equity and good conscience these proceeds are the actual property of the complaining creditors, and it cannot be possible that the parties who perpetrated the wrong and caused the loss will be allowed to appropriate to their own use any portion of the fund before the equitable owners are reimbursed.

In a recent case in the Federal Circuit Court for the Northern District of Iowa a large number of the authorities are reviewed, and the equities of persons drawn in to give credit to a failing debtor by a scheme somewhat similar to that shown in this record are discussed. Mr. Justice SHIRAS said:

"The mortgage was not recorded until April 6, 1893. "The reason why it was so withheld from record cou[illegible] have "been no other than the one given by Harris in his state- "ment to the agent of complainants, in which he stated that "it was withheld from the record because it would hurt his "credit if it was filed, and the bank assented to his request "not to record it. Having thus aided Harris in obtaining a "false credit from complainants and others, the bank cannot "now be permitted to assert that it has a debt and lien su- "perior in equity to the claims of those whom it aided in "defrauding. * * *

"The wrong and *fraud* committed against third parties "by withholding knowledge of the existence of the chattel "mortgage and the debt secured thereby is not obviated by "the mere device of securing a new mortgage or bill of sale, "as is well shown in the opinion of the Supreme Court of "Iowa in *Goll & Frank Co.* v. *Miller*, 87 Iowa, "426. The inequity chargeable against the bank "is that it aided the debtor in concealing his "real condition, and in obtaining a false "credit, thereby misleading others, and inducing them to "extend a credit which would not have been given had the "truth not been concealed. *The loss resulting from this*

"*conduct must fall upon one of the parties, and equity re-*
"*quires that it shall be visited upon the one whose miscon-*
"*duct has caused the loss.*"

Bacon v. *Harris,* 62 Fed. Rep., 105.

In that case the mortgaged property had been sold and converted into money by an assignee of the mortgagee, and the court decreed that the complainants were entitled to a decree for so much thereof as was necessary to pay the complainants' claim, interest and costs.

In another similar case the following emphatic language was used:

"Knowing that the mortgagor was dealing with the stock "as his own, and that third parties would be justified in be-"lieving that the stock belonged to Oppenheimer, free from "any lien, the mortgagee stands by and permits him to hold "himself out to the world as the owner of the stock free "from liens, and to buy on credit a very large quantity of "goods, which were added to the stock and thereby made "subject to the lien of the mortgage, as between the mort-"gagor and mortgagee. Having chosen to keep the knowl-"edge of the existence of his mortgages from the public, when "he should, in good conscience, have given publicity thereto, "and having thereby misled the creditors into making large "sales of goods on credit to the mortgagor he should not "now, when it is to his advantage and to their injury, be al-"lowed to assert that he holds a valid prior lien upon the "stock of the common debtor, *the larger part of which con-*"*sists of the very goods sold by the creditors in ignorance*
"*of the existence of the mortgage.*

"Under the facts proven by the evidence, and under the "rule laid down in *Crooks* v. *Stuart,* 2 McCrary, 13; S. C., "7 Fed. Rep., 800; *Argall* v. *Seymour,* 4 McCrary, 55, and "*Robinson* v. *Elliott,* 22 Wall., 513, it must be held that "the mortgages executed and delivered to Ayres are *in fact* "*fraudulent* against Simon, Strauss & Co., and that the

"*latter, as against Ayres, and those claiming under him,*
"*are entitled to the proceeds of the mortgaged property.*"
Simon v. *Oppenheimer*, 20 Fed. Rep., 556.

See, also,

Rumsey v. *Town*, 20 Fed. Rep., 558, and
Argall v. *Seymour*, 4 McCrary, 158.

These cases lay down the same doctrine.

Gill v. *Griffith* was a carefully considered case in the High Court of Chancery of Maryland. The opinion is cited with approval and discussed at some length by the Supreme Court of the United States in the *Blennerhassett* case, 105 U. S., 119.

In the *Gill* case the instrument condemned by the court was a bill of sale in the nature of a mortgage on the debtor's household goods. It was originally executed on March 22, 1845, to secure a new advance of about $6,000. It was executed to help the mortgagor out of financial embarrassments, in the confident belief that he was solvent, and the *bona fide* expectation that the financial relief afforded would be successful in putting the mortgagor on his feet. The mortgage and subsequent renewals of the same instrument were kept off the record until June 4, 1846, when the last renewal was recorded. In the meantime the *mortgagee* made further advances to the amount of $4,000. In the opinion, Mr. Chancellor Johnson elaborately reviewed the facts and authorities on the subject, and said, among other things:

"Independently of authority, nothing strikes the mind
"with more force than that if one of two innocent persons
"must suffer, the loss should fall upon that one whose act
"has occasioned the calamity. Now, can there be a reason-
"able doubt that the act of the defendant, Griffith, in grati-
"fying the defendant, Schley, in what is called a natural
"desire of avoiding the mortification of having the condition

"of his affairs exposed to the knowledge of the citizens of "Baltimore, has caused a heavy loss to the complainants, "Mrs. Duncan and Mrs. Handy? Upwards of twelve thou- "sand dollars of this trust money was received by him in "the months of October and November, 1845, WHEN THE "PROBABILITIES ARE VERY STRONG, if the desperate con- "dition of his affairs as disclosed by these mortgages, had "been known, steps would have been taken in time to pre- "vent the receipt of the money by him. The object of Grif- "fith, as he says, was to gratify Schley in this very natural "desire, but surely he had no right to indulge himself in "this way at the expense of third persons. If he must in- "dulge Mr. Schley in such desires, it would seem to be no "more than even-handed justice that he should do so at his "own risk. * * *

"Nothing seems to me more plainly sanctioned by the "principles of equity than that a man should not only be re- "sponsible for the direct effects of his acts, but likewise for "all the consequences which may naturally and reasonably "be expected to flow from them. * * *

"Entertaining these views, a decree will be signed vacat- "ing the mortgage of the personal estate of the 4th of June, "1846, and appointing a trustee for the sale of the property "contained in it for the payment of the claims of the com- "plainants."

Gill v. *Griffith*, 2 Md. Ch., 281.

The Supreme Court of Iowa, in 1893, discussed a concealed mortgage transaction, where likewise the mortgagee's claims had been increased from $7,500 to $12,222, by new loans made during the period in which the mortgages were kept off the record. The court say:

"There can be no doubt that the withholding of the mort- "gages from record, in pursuance of an agreement between "the parties, could have but one object, and that was to main- "tain the credit of Miller and lead parties with whom he "dealt to give credit to him, in the belief that he was not a "chattel mortgaged merchant. In such a case it is well

"settled that the mortgagee cannot be permitted to insist on "the validity of his mortgage, as against those who have "given credit to the mortgagor under such circumstances. "*Such a transaction is fraudulent as to the other creditors.*

* * * * * *

"But the bill of sale could not purge the several mort- "gages of their *fraudulent* character. The mischief was "done by withholding the mortgages from record. *It is "fair to presume that if the mortgages had been placed on "record, the plaintiffs would not have been creditors of Mil- "ler.*"

Goll & Frank Co. v. *Miller,* 87 Iowa, 426.

And accordingly, the court affirmed a decree which had awarded the complaining creditors priority in the distribution of the proceeds of the mortgaged property. The language of the *Goll & Frank Co.* case is quoted with approval, and the doctrine there laid down as to the fraudulent character of such mortgages is expressly affirmed and relied on in *Falker* v. *Linehan,* 88 Iowa, 641, and *Liddle* v. *Allen,* 90 Iowa, 741.

The decree of distribution ordered by the Supreme Court of Michigan in a recent case is important to be considered here. The facts were that one Rumsey had obtained a chattel mortgage for $1,900 in April, which he did not record until July. Between the date and the recording of Rumsey's mortgage complainants and others gave credit to Harl & Stevens, the mortgagors, by sales, loans and extensions. A former decree had been made, declaring the Rumsey mortgage fraudulent and void as to creditors whose debts were contracted during the interval between the date and recording of the mortgage. The matter coming up on the question of distribution, the Supreme Court said:

"We think, therefore, that the decree of distribution "should be framed on these principles: It should, after

"making allowance for expenses and charges out of the gen-
"eral fund, and not out of the preferred fund, direct the
"amount of $1,900 and interest from the date of the Rum-
"sey mortgage, to be paid as follows: Five hundred dollars
"to Rumsey for exemptions; the remainder to be divided
"ratably between complainants and the other creditors whose
"claims were made, or affected, as before mentioned, during
"that interval, so far as it will go.

* * * * * *

"Lastly, for the balance due Rumsey on his mortgage,
"and for any balance due the complainants and the other
"partly-paid creditors, as aforesaid, they will participate
"ratably in the distribution of the residue."

Root v. *Harl*, 62 Mich., 423.

We will not further multiply quotations from the authorities. In the decisions cited and discussed in other divisions of this brief the same principles are announced by a large number of courts of last resort.

XI.

The Authorities Cited by Petitioners in Their Brief and Argument, when Read in Full and Carefully Analyzed, are not only Not Hostile to, but Directly Maintain the Contention of Respondents.

We will now discuss some of the authorities cited by Petitioners' counsel, and especially the Illinois authorities, upon which they seem to rely.

Respondents are perfectly willing to rest their case upon the Illinois authorities, because their examination will disclose to the court that there is no state in the Union in which secret liens, by way of chattel mortgage, or otherwise, are so severely condemned as in Illinois.

THE HEGELER CASE.

The case of *Hegeler* v. *First National Bank of Peru*, 129 Ill., 162, cited by opposing counsel, is disposed of by the opinion itself, where it is said:

"*There is no pretense that there was any agreement*" (by the Bank) "to conceal its claim against the Glass Com-"pany, much less that any such agreement was made for the "purpose of enabling the Company to obtain credit from "others."

The court also say (p. 162):

"It must be admitted *that if the averment that appellee* "'*agreed to conceal the same,*' (*i. e.*, the judgment notes), "'*and to allow said Glass Company to retain the full control* "'*of the property free from any record or known lien, and* "'*that in pursuance of such agreement it did conceal,*' "etc., was stricken out of the bill, it would be demurrable "for want of equity appearing on its face. *There is not a* "*particle of evidence in the record to support that aver-*"*ment.*"

Thus it will be seen that the *Hegeler* case holds that if there be a secret agreement, express or implied, by which the lien, or control *was to be kept secret*, that then such secret agreement vitiates the transaction and makes it *actually fraudulent*.

THE FIELD-RIDGELY CASE.

The case of *Field* v. *Ridgely*, 116 Ill., 424, was decided upon demurrer. A bill was filed in that case by a creditor to set aside certain preferences on the ground that they were fraudulent. The case was decided upon the allegations of the bill. The case shows that *the bill did not contain a solitary averment establish-*

ing, or tending to establish that any agreement had ever been made between the debtor and creditor, by which the judgment notes and mortgages, under which the preferences were secured, should be kept off the record, in order to give the debtor a fictitious credit, or any credit whatever.

On this subject the Supreme Court say in the *Ridgely* case, at page 430:

"The theory of appellants' case * * * is not as "clearly defined as could be wished. This doubtless result- "ed from the scarcity, or indifferent character of the ma- "terial at the hands of counsel in propounding the theory."

Then, after discussing some vague theory set out in the bill that appellees were *ex maleficio* trustees, with respect to which the court say, "it is clear the charges in the bill "are not sufficient to sustain it on this theory," the court continues:

"But outside of this, the acts of fraud relied on to raise "the constructive trust, are wholly insufficient. Indeed, of "themselves, they are no evidence of fraud at all. What "are they? 1st. That appellees failed to put their mort- "gages on record when executed. 2d. That they retained "in their possession the judgment notes an unreasonable "length of time without notifying appellants or others of "their existence. *These are the only tangible facts alleged "in the bill upon which the charge of fraud is based.* We "are aware of no principle outside of self-interest and pru- "dence in business, that requires the holder of a mortgage "to put it on record at any particular time. By not doing "so promptly, he runs the risk of having it postponed to "junior liens, and even of losing the benefit of it alto- "gether."

The court will observe that the risk thus pointed out in the *Ridgely* case, never existed in the case at bar. By the January scheme, the Rubber Companies ingeniously escaped this risk by controlling the Board of Directors, and thereby

paralyzing the volition of the debtor company. We have already shown that the taking of a chattel mortgage was earnestly discussed at the Auditorium meeting on January 2, and was rejected by the Rubber Companies' counsel, because Mr. Beale well knew that a chattel mortgage kept off the records under the circumstances disclosed in this case, would have been worthless. This is the language of Mr. Beale on that subject (Rec., 567):

"*I did not take for the Rubber Companies a chattel mortgage on the stock of goods of the Fargo Company for two reasons: 1st. It was a shifting, changing stock. 2d. It involved putting the chattel mortgage on record, which would have ruined the credit of the Fargo Company.*"

The question of a secret understanding, or agreement by which the judgment notes and mortgage (on real estate and not on a shifting stock of merchandise), were to be kept secret and off the records, *did not arise in the Ridgely case.* The bill itself did not claim, or aver that any such agreement, or any facts or circumstances from which such secret agreement might be reasonably inferred, ever at any time existed.

While in the case at bar, the parties were searching the books and exhausting their ingenuity in devising some plan by which the secrecy of the transaction might be maintained, and at the same time, the advantages of a publicly recorded document, preserved.

THE HAAS-STERNBACH CASE.

Counsel for petitioners, for some unaccountable reason, seem to pin their faith to the case of *Haas* v. *Sternbach*, 156 Ill., 44. This was, technically considered, a *mortgage case.* The mortgage under investigation in that case

was not given by the debtor firm itself, but on the contrary was a *real estate mortgage* of his own individual property given by one of the partners. The Illinois court directs attention to this fact as having weight in determining the intention of the parties.

The court say at page 56:

"*There was no agreement or promise to keep the mort-*
"*gage secret,* but simply that it should not then be record-
"ed," and (on pages 55 and 56), "While the unsworn
"answer of Henry Leopold sets up conversations between
"himself and Charles Sternbach relative to keeping the
"mortgage off record and concealing it from others, which,
"if true, *would establish a wicked conspiracy to defraud*
"*creditors by giving a false credit to himself and his firm,*
"his own testimony does not support those allegations. We
"have gone over his entire testimony as well as that of
"Charles Sternbach and Oscar M. Stern, who testified to
"a conversation with Leopold, on the subject of making the
"mortgage, about the time it was executed, and we are un-
"able to find sufficient evidence to establish a fraudulent
"design or purpose on the part of the complainants or
"Charles Sternbach, in withholding the mortgage from
"record. The testimony of Sternbach corroborated
"by that of Stern, is to the effect that it was so
"withheld at the request of Leopold, as a favor to him, *with*
"*the understanding that the mortgaged property would*
"*shortly be sold, and the indebtedness liquidated.*"

It is clear from the opinion of the court as a whole, that the decision was based on the conclusion that the record did not establish *an understanding or agreement to keep the mortgage secret in order to sustain the credit of the mortgagor and his firm,* and that if the record had shown an agreement, or understanding for that specific purpose the court would, using its own language, have condemned it as "A WICKED CONSPIRACY TO DEFRAUD CREDITORS."

If an agreement to keep the *Haas-Sternbach* mortgage secret would have been "*a wicked conspiracy to defraud creditors,*" how shall we fitly characterize the January scheme. There is no word or phrase in the English language, rugged as it is, to do the subject justice.

The *Haas-Sternbach* case was under consideration in the Appellate Court for the First District of Illinois in *McNeill* v. *Plows*, 83 Ill. App. Ct., 186, and the decision of that court ends all controversy on this question, if any real controversy as to the meaning of the Supreme Court of Illinois, in the *Haas-Sternbach* case were possible. We respectfully urge the court to read the *McNeill* opinion. The *Haas* case went to the Supreme Court of Illinois by way of the Appellate Court, and therefore, the latter tribunal was able, from an examination of its own files and records, to determine what the allegations of "an "unsworn answer of Henry Leopold" were as to the "conversations between himself and Sternbach relative to keeping the mortgage off the record and concealing it from "others."

In discussing the *Haas* case, the Appellate Court said:

"The case was affirmed by the Supreme Court (*Haas* v. "*Sternbach*, 156 Ill., 44-55), in which it is said, 'while the "unsworn answer of Henry Leopold sets up conversations "between himself and Charles Sternbach relative to keeping the mortgage off record and concealing it from others, "which, if true, would establish a wicked conspiracy to "defraud creditors by giving a false credit to himself and "his firm, his own testimony does not support these allegations.' *From an examination of the abstract and of the "answer referred to in that case in this court,* we find statements which make the case in point of fact quite similar "to the case at bar, and we regard *the language of the Supreme Court, when considered with reference to the state-*

" ments of the answer, as deciding that where a party takes " a mortgage and keeps it off record in order to support the " credit of the maker, upon the condition or agreement that " the maker shall keep him informed of his affairs so that " if any trouble is likely to arise with the maker's creditors, " the grantee can place his mortgage upon record, such a " transaction is a fraud in fact. See also *Weber* v. *Mick*, " 131 Ill., 520-6."

The question involved in the *McNeill* case was, whether or not the concealment of a bill of sale constituted an *actual fraud* as distinguished from a *constructive fraud*. The case was a statutory attachment proceeding. The attachment was sued out on the ground that the defendants had committed *an actual fraud* in concealing the bill of sale. In Illinois it is the settled law that actual fraud must be shown in order to maintain a statutory attachment sued out on the *ground of fraud*. The trial court held that the transactions in question constituted merely a *constructive fraud*, and accordingly instructed the jury to find the issues for the defendant in the attachment suit. The Appellate Court, however, held that the evidence, if true, constituted *actual fraud*, and therefore, the question should have been submitted to the jury as to the truth of the facts themselves.

In connection with the *McNeill* case, we direct the attention of the court to the telegram sent by Beale to Sadler on July 16 (Rec., 593-4), in which he said:

" Fargo promises to keep me informed so that if necessary, " judgments can be entered on our judgment notes."

This telegram presents a condition of things identical with what existed in the *McNeill* case.

In view of the conclusive character of the evidence in this record, showing that the parties not only expressly arranged and intended that the January scheme should be

kept secret for the very purpose of sustaining the credit of the Fargo Company, but that in fact this intention and understanding was carried out and fortified by elaborate precautions, it must be clear that the *Haas* case is a strong authority in support of our contention.

The Supreme Court of Illinois never had before it, so far as we have been able to ascertain, a case like the one at bar; but the spirit of its decisions must satisfy this court that should such a case ever be there reviewed, it would receive the severest condemnation. In all the *Illinois unrecorded mortgage* cases cited by opposing counsel, the Supreme Court lays great stress upon the fact that *an agreement, or understanding that the mortgage should be concealed,* in order to give the failing debtor a false credit, was either not alleged or not supported by the evidence; and that if any such agreement, or understanding had been disclosed in these cases, the court would have condemned it as constituting an actual fraud, or to use Judge Mulkey's emphatic words, in the *Field-Ridgely* case, *supra,* "A WICKED CONSPIRACY TO DEFRAUD CREDITORS."

THE CASE OF ATWATER V. AMERICAN BANK, 152 ILL., 605.

In their brief counsel say they do not overlook the *Atwater* case, and suggest "it seems to have been regarded "as a case of actual fraud." The *Atwater* case is directly in point as to the fraudulent conduct of the Rubber Companies and the Metropolitan Bank when the final collapse of the Fargo Company took place in August, 1896. Counsel's suggestion that "it seems" that the *Atwater* case was regarded as one involving actual fraud, is amusing, in the light of the vigorous language used by the Supreme Court of Illinois on that subject. That case is analyzed and ap-

plied to the facts in this case at pages 106-108 of this argument, where we discuss the conduct of the Rubber Companies and the Bank, to which we respectfully refer the court.

THE SANFORD TOOL COMPANY CASE AND THE ILLINOIS STEEL COMPANY CASE.

Counsel cite these two cases in support of the proposition that preferences given to directors will be sustained, if the record shows that they were given in good faith, while the corporation was a going concern, as security for present advances, *bona fide* made, in the belief that they would help the corporation out of its embarrassments.

An examination of *Sanford Tool Co.* 1. Howe, 157 U. S., 312, and *Illinois Steel Co.* v. *O'Donnell*, 156 Ill., 624, will show that in their essential features they are strikingly different from the facts presented by this record.

1. There was no element of secrecy, either by agreement or otherwise calculated to create a fictitious credit.

2. There was no merely colorable election of dummy directors for the sole purpose of secretly and adversely controlling the actions of the corporation in the interest of a favored creditor, and forever excluding all other creditors.

3. On the contrary, the directors in the *O'Donnell* and *Sanford Tool* cases were all *bona fide* directors, openly and publicly acting as such and using their best experience and ability in good faith to advance the interests of the corporations in their keeping.

4. As a natural conclusion from these facts there was no question in either of these cases as to the effect of an arrangement like the January scheme in creating a secret lien, or fictitious credit, nor were the rights of persons drawn in to give credit by such a secret and fraudulent arrangement presented to, or discussed by either court.

5. In the *Sanford Tool* case it was admitted on the record by the pleadings that the CONDUCT OF ALL PARTIES WAS CHARACTERIZED BY GOOD FAITH. (p. 319.)

6. The insolvency of the concerns was by no means hopeless or even serious. In the *Sanford Tool* case the property and assets were amply sufficient to pay all the indebtedness, if the property was worth *what it had recently cost in cash.* In the *O'Donnell* case it was said that the concern was meeting its commercial obligations as they matured. The security given in these cases was a reasonable and usual security. In the *Sanford Tool* case the security was a second mortgage on real estate already encumbered for a large sum; *all the other property of the corporation was left free for the other creditors.* In the *O'Donnell* case the *only security taken was a judgment note for an actual advance made at the time*, and not for any pre-existing debt.

The Supreme Court of Illinois say in the *O'Donnell* case, that the company,

"Got the benefit of the moneys so borrowed and they were "used in completing the new plant that it constructed at "a cost of some $280,000, and in conducting and keeping on "its feet its large manufacturing business. The banking "firm did not obtain or anticipate receiving any advantage "to itself by loaning the money to the corporation, other "than that of getting interest on the money that it loaned. "The corporation at the time of these transactions was em"barrassed for want of means—in fact, insolvent in the "sense that its liabilities exceeded its assets—and it was "forced to adopt various temporary shifts and expedients "for the purpose of raising money. At the same time it "was a going concern; had an extensive plant which had "cost it over a quarter of a million dollars, and was unincum"bered; was employing some 300 workingmen; had on hand "manufactured products worth about $200,000, and was "doing a large business and meeting its commercial obli-

"gations. * * * There is a marked difference between "a case where a *mortgage or other preference is given by "an insolvent corporation to a director or officer to secure "a pre-existing indebtedness*, and a case like this where the "corporation though in fact insolvent in the sense above "stated is a going corporation that is seeking to accom- "plish the objects of its incorporation, and the security is "given to the directors for moneys actually and in good "faith loaned at the time the security is given to such em- "barrassed corporation and for its benefit."

In this same opinion the language of Mr. Justice HARLAN, in *Sutton Manf. Co.* v. *Hutchinson*, 11 C. C. A., 320, on that subject is cited with strong approval, and especially that portion which reads:

"Of course, in cases of that kind (security given to di- "rectors) a court of equity will closely scrutinize the trans- "actions, and in a contest between general creditors and the "director, or managing officer who takes a mortgage upon its "property, will hold the latter to clear proof that the mort- "gage was executed in good faith and was not a device to "enable him to obtain an advantage for himself over those "interested in the distribution of the mortgagor's property."

Further on, at page 636, in the *O'Donnell* case, it is said:

"THE LINE OF DEMARCATION THAT SEPARATES VALID FROM "INVALID PREFERENCES TO DIRECTORS OR OFFICERS OF IN- "SOLVENT CORPORATIONS, LIES BETWEEN ALREADY INCURRED "LIABILITIES AND LIABILITIES ASSUMED BY GOING CORPO- "RATIONS AT THE TIME THE SECURITY IS GIVEN AND TAKEN."

Opposing counsel's suggestion that the $50,000 credit advanced to the Fargo Company in January, brings this record within the rule laid down in the *O'Donnell* case, will not bear the light of legitimate inquiry and criticism.

The Rubber Companies never intended to advance a dollar, either in money or credit, until they were forced to do

so, by the threat of the Fargos to "treat all creditors alike." On the contrary, Johnson pleaded with Fargo, that it was his duty then and there, on January 2d, to protect and prefer the Rubber Companies for the full amount of their past due claims then aggregating $284,000, including the value of the consigned goods. This Fargo refused to do. As the only alternative left the Rubber Companies purchased the preferences they secured by the January scheme, by then and there agreeing to advance to the Fargo Company $50,000 in credit.

But the court must remember that this advance was made upon the express agreement that the $44,900 notes due the Candee Company must absolutely and unconditionally be paid as they matured within four months, and were in fact so paid by about May 1st; and that the whole of the remaining Rubber Company claims must be absolutely secured beyond the possibility of further risk or hazard; and the parties thought they had done this; hence it follows that the preferences given in the case at bar were given to the directors, or to the parties whom the directors expressly represented, for a pre-existing debt, expressly condemned in the *O'Donnell* case.

In the light of these facts (given in detail in our statement), it is absurd for Petitioners to contend that the $50,000 of credits so advanced has anything in common with the moneys advanced by the banking institution to the Illinois Steel Company as recited in that case.

The foregoing considerations demonstrate that this line of authorities does not apply to the facts in this record. The Rubber Companies themselves insist that the only functions which their dummy directors were to perform were such as involved hostility to the corporation. Though wearing the

badge of the Fargo Company, and nominally enlisted in its service, they were in fact actually serving in the ranks of its enemies. They were never *bona fide* directors seeking the company's welfare, but *mala fide* directors, placed in secret control of the corporation to effectuate the selfish ends of their employers.

The organic law under which the Fargo Company was created, provides that "the corporate powers "shall be exercised by a board of directors or man-"agers." (R. S. Ill., Ch. 32, Sec. 6.) It is elementary that directors can act only by a vote of a majority of the board. It is insisted by the Rubber Companies that it was expressly agreed and an essential part of the arrangement under discussion, that the *mala fide* directors were to perform absolutely no functions to further or effectuate the corporate business, and that this express agreement was carried out. Now these dummy directors constituted five out of seven—a majority of the board—and an agreement that the majority of the board shall perform no functions is tantamount to an agreement that the directors shall, in fact, cease to act. Under a charter which provides that the corporate powers can only be exercised by a board of directors, such an agreement is equivalent to an agreement that the corporate powers shall not be exercised. But this pretense that the dummy directors were to exercise no active functions is on a par with the other pretenses of the Rubber Companies in this case. The draft of the proposed agreement itself, prepared as a basis for the January scheme, but afterwards abandoned in favor of an "open arrangement," provides:

"The directors and officers elected at the instance of said "Beale * * * *are expected to act as may be necessary "to guard and protect the interests of said Johnson and of*

"*said two creditor corporations under this agreement.*" (Rec., 588.)

Elsewhere in this brief will be found a discussion of the true character of these directors. (p. 75.) It is sufficient at this point to call attention to the fact that when the crisis came, and affirmative action on the part of the directors was needed, these young clerks were called in by Porter, and by his direction voted the Bank's judgment notes and the conveyance of the Dixon property to the Bank, which in itself constituted a direct affirmative preference to the Rubber Companies by the Fargo Company while it was in the throes of dissolution. For at the time this vote was taken, the Rubber Companies and the Bank had entered into a written agreement, whereby the Petitioners were to share *pro rata* in the proceeds of the Dixon real estate and the Bank's judgment. This fact itself is a sufficient answer —if any were needed—to the claim that the preferences in question were given in January.

The language of Mr. Justice FIELD in *Wardell* v. *Ry. Co.*, is pertinent here. Speaking of the directors under discussion in that case he said:

"They were clothed with power to manage the affairs of "the company for the benefit of its stockholders and creditors. Their character as agents forbade the exercise of "their powers for their own personal ends against the interest of the company. * * * Their position was one of "great trust, and to engage in any matter for their personal "advantage inconsistent with it was to violate their duty "and commit a fraud upon the company."

Wardell v. *Ry. Co.*, 103 U. S., 657.

So Mr. Justice DAVIS said:

"Bound to execute the responsible duties intrusted to their "management with absolute fidelity to both creditors and

" stockholders, they nevertheless acted with reckless disre-
" gard of the rights of creditors as meritorious as those whose
" paper they had endorsed."

Drury v. *Cross*, 7 Wall., 302.

In this discussion of the *Illinois Steel Company* case it is of more than passing interest to remind the court that this case was carefully analyzed, discussed and considered by both Beale and Porter when they were putting the January scheme into shape and force. They admit that had it not been for this case the dummy board of directors, instead of the old board, would have voted the judgment notes and powers of attorney. They thought, however, by directing the old board to vote these secret liens they would escape the rule laid down in that case. Upon that subject Mr. Porter, one of the Rubber Companies' counsel, says (Rec., 446):

" *The reason which actuated Mr. Beale and me to have the*
" *judgment notes made by the old board instead of the new,*
" *and have them delivered prior to the change in the board*
" *of directors was, that we considered it better to do so, be-*
" *cause of the application of the rule that a director of an*
" *insolvent corporation is not allowed to secure any benefit*
" *to someone whom he represents.* We looked up several
" cases, among them that of *Blair* v. *Illinois Steel Company.*"

By inadvertence Mr. Porter names the case of *Blair* v. *Illinois Steel Co.*, reported in 159 Ill., 350, instead of *O'Donnell* v. *Illinois Steel Co.* Both cases grew out of the same litigation and involved substantially the same questions so far as they are materia' here.

On the same subject Mr. Beale says (Rec., 447):

" *I concluded it would be safer for the old board to act*
" *to avoid any question which might be made in the future.*"

Is it possible, in the light of these confessions made by both counsel who had active and controlling charge of the

January scheme, to believe, that they and their principals were not then firmly of the faith that the Fargo Company was hopelessly insolvent and were then preparing for and fortifying themselves against the attack of subsequent creditors? If not, why did they give the subject of *insolvent corporations* and preferences to "*some one whom the director represents*" such careful and profound study?

Conclusion.

It will be no comfort to the Respondents for the court to say, that their wrongs would be redressed if Petitioners had, at the time they committed the frauds in question, a present, conscious intent to injure Respondents. These injured creditors reply, conscious, or unconscious intent, to them the loss and injury is the same. They will never understand such a metaphysical distinction.

If, when the January scheme was launched, the moral perceptions of the men engaged in that enterprise were so perverted that they "imagined an act to be fair and honest "which the law justly pronounces fraudulent and corrupt," shall such a perverted moral sense excuse Petitioners from their responsibility for the damage they have done? There can be no code of morals, or of law, in a community governed by law, which does not hold men to a full accountability for the ordinary and natural consequences flowing from their acts and conduct—especially when it is shown, as in this record, that such acts and conduct are the result of deliberate premeditation.

The representatives of the Rubber Companies were exceptionally able business men of large experience in such matters. They had the advice of able and astute counsel, who

by their own admissions in this record, considered the legal consequences of every step contemplated and of every step actually taken.

The January scheme was deliberately planned and as deliberately put into execution, and every natural consequence flowing therefrom must have been present to the minds of the Petitioners and their counsel. Therefore, we respectfully insist that they can not now claim immunity as the result of haste, oversight or mistake.

Nothing short of holding, as did the Circuit Court of Appeals, that the Petitioners ought not to share in the Fund now in the hands of the Receiver for distribution, will do justice to these injured creditors and protect the commercial world from similar fraudulent schemes.

We earnestly believe that we have established beyond serious controversy that the Rubber Companies in January and August and the Bank in August, were guilty of actual fraud, and therefore must be excluded from participating in the Fund until Respondents and the other innocent creditors have been paid in full.

Respectfully submitted.

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